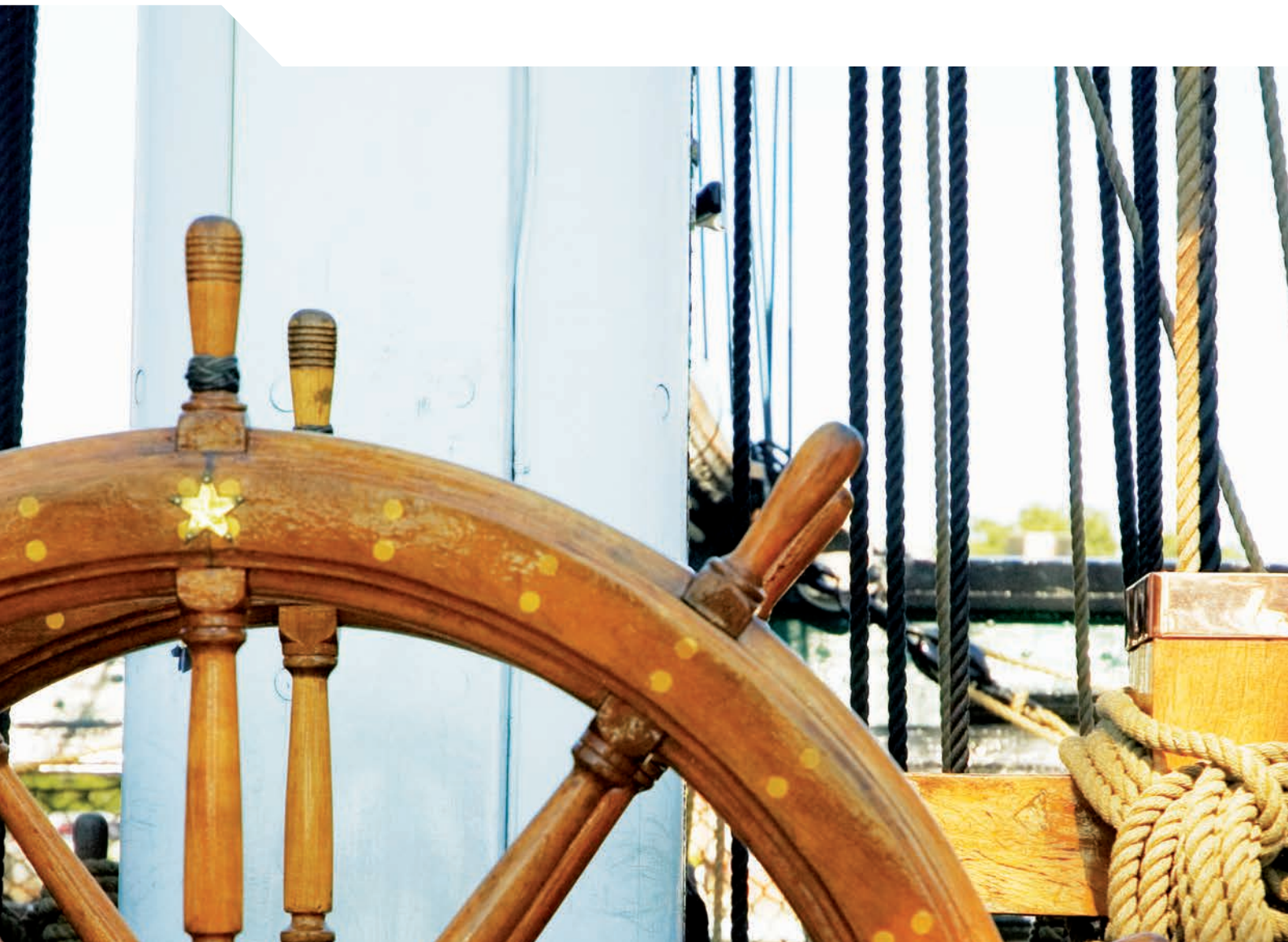




Value for Money in Government

Building on Basics



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Foreword

This report is published as part of the OECD *Value for Money in Government* series. This project, launched in 2008 on the initiative of the Dutch government, aims to identify new developments in the administration of central government that lead to better value for money: better services at lower costs for the taxpayers.

The first report in the *Value for Money in Government* series was published in 2010 under the title *Public Administration after “New Public Management”*. The title of this first report expressed an important feature of developments in public administration that have come to the fore in the last decade: a certain change of cap vis-à-vis the reform trends of the 1980s and 1990s in the direction of a simpler, more compact, more integrated administration and a shift of financial resources from administration to service delivery. In other words: “more front office, less back office” or as the Danes say: “less cold hands, more warm hands”. In subsequent years, five reports were published on separate countries that have financed the project (the Netherlands (2010), Denmark (2011), Australia (2012), Sweden (2013) and Norway (2013)). Each country report presents ten reforms that have occurred in other countries and that are particularly relevant for the country concerned. The current report is a synthesis report that concludes the project. It gives an overview of 42 reforms that have occurred in the 13 participating countries that offered to provide information through a number of questionnaires. Participating countries include, in addition to the 5 countries that financed this project, Austria, Canada, Finland, France, Ireland, New Zealand, Spain and the United Kingdom.

The reforms presented in this synthesis report are selected because they fit into the trend to a simpler, more compact and more integrated public administration, and also because they offer good examples of new initiatives for better service delivery, making optimal use of innovative technology. The title of the study aims to capture both aspects: Building on Basics.

This report was produced by a team, composed of the OECD Secretariat, in particular the Budget and Public Expenditure Division of the Directorate of Public Governance and Territorial Development, and external experts. The team consisted of: Dirk Kraan (lead), Gwen Carpenter (chapter on ICT Management), Rex Deighton Smith (chapter on Administrative Regulation and Supervision), Joan Kelly (chapter on Policy Development), Valentina Kostyleva (parts of various chapters), Joop Vrolijk (chapter on Internal Audit Management) and Joachim Wehner (chapter on Machinery of Government).

The team expresses its gratitude to its interlocutors in all participating countries who were willing to provide information to the project, to receive team members for missions to their ministries and to comment on drafts. The team also thanks colleagues in the Directorate of Public Governance and Territorial Development who were willing to comment on drafts. The team is grateful to Alessandro Lupi, who provided statistical support, Hélène Leconte-Lucas, who compiled the report and did the initial editing and Bonifacio Agapin, who did the final editing.

Table of contents

Executive summary	11
Chapter 1 Introduction	15
Background of the study	16
Aims of the study	16
Three periods of public administration	17
Problematic results of New Public Management	19
The need for consolidation as a driving factor	22
Tools of the study	22
Contents of the study	24
Notes	25
Bibliography	26
Chapter 2 Statistics	27
Introduction	28
Basic statistics of the countries included in the study	31
Employment in general and central government	33
Expenditures and revenues in general and central government	39
Notes	46
Bibliography	47
Chapter 3 Policy development.....	49
Introduction	50
Reform 3.1. Strengthening policy development capacity within line ministries	52
Reform 3.2. Integration of executive and professional expertise into policy development	56
Reform 3.3. Transfer of policy research institutions to universities, private research establishment and consultancy firms	59
Reform 3.4. Independent fiscal forecasting institutions	62
Reform 3.5. Whole of government standards for ex post evaluation	66
Reform 3.6. Whole of government standards for Regulatory Impact Analysis and for Cost-Benefit Analysis	69
Reform 3.7. A more consistent division of policy responsibilities between central and sub-central governments	76
Notes	80
Bibliography	81
Chapter 4 Policy execution	83
Introduction	84
Reform 4.1. Role of arm’s length agencies	89
Reform 4.2. Use of common process units	95

Reform 4.3. Role of independent agencies	99
Reform 4.4. Role of private non-profit institutions in service delivery	105
Reform 4.5. Reform of the foreign service	109
Notes	116
Bibliography	118
Chapter 5 Administrative regulation and supervision.....	121
Introduction	122
Reform 5.1. Reforming economic regulation: maximising the use of general and cross- sectoral regulation and regulators	124
Reform 5.2. The use of independent regulatory agencies	130
Reform 5.3. Risk based supervision	136
Note	140
Bibliography	142
Chapter 6 Support services and operational management.....	145
Introduction	146
Reform 6.1. Acceleration of service sharing	149
Reform 6.2. Concentration of standard setting units for operational management	155
Reform 6.3. Outsourcing of support services	159
Notes	162
Bibliography	163
Chapter 7 Financial management.....	165
Introduction	166
Reform 7.1. Programme classification of the budget	169
Reform 7.2. Regular updating of baseline estimates	174
Reform 7.3. Medium term expenditure framework	177
Reform 7.4. Focusing the budget documentation on financial information	182
Reform 7.5. Automatic cuts of productivity dividends	187
Reform 7.6. Strong spending review procedure, anchored in law	191
Notes	200
Bibliography	201
Chapter 8 Human resource management	203
Introduction	204
Reform 8.1. Human resource support service sharing	212
Reform 8.2. Human resources standard setting	217
Reform 8.3. More efficient standards for pay-setting	220
Reform 8.4. Reduction of abolition of performance-related pay	224
Reform 8.5. Top civil servants appointments	227
Notes	233
Bibliography	234

Chapter 9 ICT management	235
Introduction	236
Reform 9.1. Improvement of ICT standards.....	244
Reform 9.2. Common ICT process units.....	253
Reform 9.3. Gateway procedures	259
Notes.....	263
Bibliography.....	264
Chapter 10 Internal audit management	269
Introduction	270
Reform 10.1. Ensuring independence of Internal Audit.....	272
Reform 10.2. Criteria for need and size of internal audit.....	277
Reform 10.3. Limit the remit of Internal Audit to its core task: to support risk management.....	280
Notes.....	285
Bibliography.....	286
Chapter 11 The machinery of government	287
Introduction	288
Reform 11.1. Contain the number of ministers	289
Reform 11.2. Minimise the number of deputy ministers and other political officials.....	295
Reform 11.3. Strictly limit the number of political advisers to ministers	300
Reform 11.4. Simplify cabinet committee structures	302
Notes.....	305
Bibliography.....	305
Chapter 12 Steering of agencies	309
Introduction	310
Reform 12.1. Output steering in agencies	312
Reform 12.2. Financing of agencies.....	316
Reform 12.3. More professional ownership of agencies	320
Notes.....	324
Bibliography.....	324
Annex A List of reforms	325
Glossary	329

Figures

Figure 2.1a. Employment in general and central government relative to population.....	33
Figure 2.1b. Employment in general and central government relative to domestic employment.....	34
Figure 2.2. General and central government expenditure relative to GDP (2011) (percentage of GDP).....	39
Figure 3.1. Small cadre of policy development officials.....	55
Figure 3.2. Size of core ministries and executive agencies	58
Figure 3.3. The RIA process in Australia.....	73
Figure 9.1. ICT support services units.....	238
Figure 9.2. Is there one or more shared support service centres in your central government that provide ICT support services to ministries?	239
Figure 9.3. ICT spending in the UK.....	241
Figure 11.1. The number of ministers with full cabinet rank	291

Tables

Table 2. 1. Administrative and in-kind service delivery employment in the organisations of central government (A = administration; S = service delivery in kind; X = does not occur).....	29
Table 2.2. Basic statistics of the countries included in the study (2011).....	32
Table 2.3. Employment by levels of government (2011) (percentage of general government employment).....	35
Table 2.4. Central government employment by administrative and in-kind service delivery employment (2009)	36
Table 2.5. Central government administrative employment by type of activity (2009) (Percentage of total administrative employment in FTE).....	37
Table 2.6. Central government administrative employment by type of organisation (2009) (percentage of total administrative central government employment in FTE)	38
Table 2.7. General government expenditures by level of government (2011) (percentage of general government expenditure).....	41
Table 2.8. Central government ¹ expenditure by policy areas (2011) (percentage of central government expenditures)	42
Table 2.9. Central government ¹ outsourcing rates by policy areas (2011) (percentage of total expenditure by policy area)	44
Table 2.10. Own tax revenue as share of total revenue by sub-sector of general government (2010) (percentage of total revenue)	45
Table 3.1. Tasks of forecasting and costing institutions in selected OECD countries	63
Table 4.1. Taxonomy of the organisation of central government.....	86
Table 5.1. Number of supervisory/regulatory authorities by status.....	132
Table 6.1. Shared Service Centres (SSC).....	149
Table 6.1. Shared Service Centres (SSC) (continued).....	150
Table 6.2. Incentives, Funding and Efficiency Gains of Shared Services.....	151
Table 6.3. Government-wide standard setting in France.....	157
Table 6.4. Government wide standard setting in Denmark	158
Table 7.1. Stylised budget classification	173
Table 7.2. Key features of the arrangements of the reform.....	188
Table 7.2. Key features of the arrangements of the reform (continued).....	189

Table 7.3. Key features of national practices	193
Table 7.3. Key features of national practices (continued)	194
Table 7.3. Key features of national practices (continued)	195
Table 7.3. Key features of national practices (continued)	196
Table 7.3. Key features of national practices (continued)	197
Table 8.1. Wage bargaining in some OECD countries	221
Table 9.1. Costs of ICT	242
Table 9.2. Broad organisational approach to e-government	251
Table 9.3. Responsibility for central registers in selected countries	255
Table 9.4. Overview of 8 basic registers in Denmark	256
Table 10.1. Internal Audit Legislation	273
Table 10.2. Internal Audit Organisation and Staff	278
Table 10.3. Scope of Internal audit	280
Table 10.3. Scope of Internal audit (continued)	281
Table 11.1. The legal basis for the number of ministers	293
Table 11.2. The number of cabinet committees	303
Table 11.3. Cabinet Committees in Canada	304
Table 12.1. Number of agencies per Dutch ministry	321
Table 12.2. Number of principals of Dutch arm's length agencies	321
Table 12.3. Supervision by Finance directorates of ministries on agencies in the Netherlands (number employees in FTEs1)	322

Executive summary

Background of the study

The OECD Value for Money project was launched in 2008 at the request of the Dutch government. The OECD Secretariat was asked to conduct a comparative study on the organisation of central government from the perspective of Value for Money. The Dutch Government was interested in both quantitative and qualitative international data. In order to conduct the study, the OECD invited a number of countries to provide information to the project. The selection of countries took place in consultation with the Dutch Government. The countries that accepted to participate were: Austria, Australia, Canada, Denmark, Finland, France, Ireland, New Zealand, Norway, Spain, Sweden and the United Kingdom. Furthermore, some of those countries were interested in a specific country review next to a comparative international study and offered to contribute to the financing of the project (Australia, Denmark, the Netherlands, Norway and Sweden).

From 2009 to 2013 six reports have been published as products of the Value for Money project. The first report “Public Administration after New Public Management” (2009) provided internationally comparable statistical data about government employment and expenditures and explored current trends in administrative reform. The second to sixth reports (2010-2013) were country reviews. Each country review contained ten reforms that had occurred in other participating countries, but not (yet) in the country under review, and that were particularly interesting for the country under review. In the beginning of 2014, the current synthesis report “Building on Basics”, was completed.

The current report is not specifically focused on the Netherlands. This approach is in line with the aim to produce a comparative study that would be equally useful to all participating countries. It should be noted that, for the most part, the countries in this report share a common set of characteristics: a strong public service capacity developed over a long period of time with a shared ethos and tradition of public service; a rigorous and well-understood legal system in the common law or continental civil law tradition; and a solid experience in evidence based policy analysis and evaluation. For countries interested in replicating these reforms, it is essential that they first understand the pre-conditions and context that have supported the reforms presented here, and analyse their own potential costs, benefits and risks in their own organisational, legal and political contexts.

Aim of the study

The aim of the OECD Value for Money project is to describe recent reforms in the organisation of central government of the participating countries that are interesting for other countries from the perspective of value for money.

This aim implies that the study analyses the organisation of the central government. As far as financial resources are concerned, it is limited to the operational expenditures (compensation of employees, intermediate consumption, and administrative investment) for public administration. Programme expenditures (transfers, subsidies, programme

investment, social benefits, interest, etc.) are excluded. Similarly, expenditures for public in-kind service provision (education, health, social services, etc.) are excluded.

The perspective of value for money implies that reforms must lead to better quality of services for citizens and businesses or to savings, or to both. In view of the deteriorating economic circumstances during the course of the study, the emphasis has gradually shifted towards savings, but reforms leading to improvement of quality of services that do neither lead to savings nor to additional expenditures have been included.

The value for money perspective has also been interpreted in a more specific sense, namely as characteristic for a next phase in the development of public administration. Since the mid-2000s a new period of public administration can be observed. Some of the New Public Management reforms, which were characteristic for the period 1990-2005, are adjusted, revised or even abolished, and new trends come to the fore. These trends include:

- Smaller core ministries, focusing on policy development and policy evaluation;
- A more logical and transparent separation of tasks between central government and local government;
- Better integration of executive and professional expertise in policy making (vertical integration);
- Sharing of process units and amalgamation of executive agencies (horizontal integration);
- Integration of regulatory and supervisory units (inspectorates) and risk based supervision;
- Support service sharing;
- Concentration of standard-setting for operational management (finance, human resources and organisation, information and ICT, procurement, communication, internal audit, accommodation, real estate and facilities) in one or two ministries;
- Less politicians and political advisors at the top of ministries
- Better and more professional financing of agencies, focusing on the costs of required capacity (capacity budgeting).

A common feature of these trends is that the government should focus more on in-kind service delivery and less on administration, in other words: more front office, less back office, or as the Danes say: “more warm hands, less cold hands”. This implies not only shifting resources from administration to in-kind service delivery, but also building a simpler, more integrated, more compact administration, denoted in this study as a move towards “basic government”.

In view of the specific interpretation of the value for money perspective as characteristic for a new phase in the development of public administration, the reforms described in this report have been selected on the basis of whether they fit into the mentioned reform trends (next to the other criteria mentioned above). This way of selecting the reforms is intended to provide certain coherence to the report that would otherwise be lacking.

Structure and contents of the report

The report contains 12 chapters. The first chapter describes the background, aims and tools of the study and the sources of information. The second chapter provides statistical information. All other chapters describe the selected reforms. In total the report contains 42 reforms that have occurred in one or more countries participating in the study since 2005.

Four chapters focus on the four tasks of government that are distinguished in the study: Policy development (Chapter 3), Policy execution (Chapter 4), Administrative regulation and supervision (Chapter 5) and Support services (Chapter 6). Four chapters focus on separate support services: Finance (Chapter 7), Human resources (Chapter 8), ICT (Chapter 9), and Internal audit (Chapter 10). Two chapters focus on the government organisations: Core ministries (Chapter 11) and Arm's length and independent agencies (Chapter 12).

Each chapter starts with an introduction that mentions the most important developments in the subject area of the chapter in the participating countries then introduces the reforms described in the chapter and how they fit in the current trends. Subsequently, each chapter describes 3 to 7 reforms that have occurred in one or more countries and that are relevant for the countries where it has not (yet) occurred.

Each reform is described in four paragraphs. The first paragraph describes the essence of the reform. The second paragraph mentions the country (countries) where it occurred and provides some background on its adoption. The third paragraph provides an analysis of the reform. It mentions the aim of the reform, which problem it was supposed to solve, how the reform compares to alternative policy options and any empirical data on the impact of the reform in terms of costs or savings and effects on outputs and outcomes. The fourth paragraph pays attention to the feasibility of the reform in countries where it has not (yet) occurred. It mentions conditions that have to be met in order to implement the reform.

The Glossary of the report provides a list of the terminology used throughout the book to denote concepts that often have different names in the separate countries participating in the study.

Annex A contains a list of all 42 reforms described in the report.

Chapter 1

Introduction

This chapter provides information about the background and aims of the OECD Value for Money study. This chapter also pays attention to some tools of the study and it explains the structure of the current synthesis report.

The aim of the study is to describe recent reforms in the organisation of the central government of participating countries that are interesting for other countries from the perspective of value for money. Accordingly, reforms selected for the study must lead to better quality of services for citizens and businesses or to savings, or both.

The Value for money perspective has also been interpreted in a more specific sense, namely as characteristic for a next phase in the development of public administration. Since the 1990s public administration reform in the participating countries has been inspired by the ideas of New Public Management. These reforms have led to some good results but also to a number of problematic results. In the last decade new trends have come to the fore. The common denominator of these trends is: savings on administration for the benefit of in-kind service delivery to citizens and businesses. This implies building a simpler, more integrated, more compact administration, denoted in this study as a move towards “basic government”.

This chapter pays attention to the “snapshot of the public administration” as one of the main tools of the study. The snapshot is a statistical survey of administrative employment in central government that distinguishes four tasks of government, namely 1) policy development, 2) policy execution, 3) administrative regulation and supervision and 4) support services, as well as three types of government organisations, namely 1) core ministries, 2) arm’s length agencies and 3) independent agencies.

This chapter explains the structure of the study, which is based on the snapshot of the public administration.

Background of the study

The OECD Value for Money project was launched in 2008 at the request of the Dutch government. The OECD Secretariat was asked to conduct a comparative study on the organisation of central government from the perspective of Value for Money. The Dutch Government was interested in both quantitative and qualitative international data as background information for the operation “Central Government Reform” that was initiated in 2007. In order to conduct the study, the OECD invited a number of countries to provide information to the project. The selection of countries took place in consultation with the Dutch Government. The countries that accepted to participate were: Australia, Canada, Denmark, Finland, Ireland, New Zealand, Sweden and the United Kingdom. These countries were invited to join an advisory committee to supervise the project. The resulting OECD report “Public Administration after ‘New Public Management’” was published in 2010.

In 2010 the scope of the study was extended. From then on the study has become truly international in that it was henceforth financed by five countries (Australia, Denmark, the Netherlands, Norway and Sweden). Additional countries have pledged to provide information (Austria, France, Norway, and Spain) and have been invited to participate in the advisory committee. The aim of this second phase was to produce country assessments for the financing countries (Australia, Denmark, the Netherlands, Norway and Sweden) and a final report that would give an overview of all recent reforms of central government in the participating countries that are interesting from the perspective of value for money. The country assessments would focus on a specific country and provide quantitative and qualitative information that would be particularly useful for the country concerned. In particular each country assessment would provide information on ten reforms that had occurred in other countries but not (yet) in the country concerned, and that could be seen as particularly relevant and inspiring for the latter country. From 2010 to 2013 country assessments have been produced for Australia, Denmark, the Netherlands, Norway and Sweden. In 2014 this final report, has been completed¹.

The report is not specifically focused on the Netherlands. This is reflected in the Terms of Reference. This approach is in line with the aim to produce a comparative study that would be equally useful to all participating countries.

It should be noted that all country assessments already drew upon the final report, in the sense that they described priority reforms for the country concerned, that were selected from the list of all reforms that are described in this report. This was possible because a provisional list of reforms to be included in the final report was already made up at the start of the second phase of the project (2010).

Aims of the study

The aim of the OECD Value for Money project is to describe recent reforms in the organisation of central government of participating countries that are interesting for other countries from the perspective of value for money.

The study focuses on central government. Local government reforms have been excluded, but this restriction has been interpreted with some flexibility. Decentralisation reforms that lead to savings in central government as well as in general government (which includes local government) have been included.

The perspective of value for money implies that reforms must lead to better quality of services for citizens and businesses or to savings, or to both. In view of the deteriorating economic circumstances during the course of the study, the emphasis has gradually shifted towards savings, but reforms leading to improvement of quality of services that do neither lead to savings nor to additional expenditures have been included.

The value for money perspective has also been interpreted in a more specific sense, namely as characteristic for a next phase in the development of public administration. It is well-known that in many OECD countries, and in particular in the countries participating in the Value for Money study, three periods of public administration can be distinguished since the 1980s of the previous century: those of receding government (1980-1990), New Public Management (1990-2005) and the current period (from 2005). During the last decade in several countries, new trends have come to the fore that in some respects implied a change of cap *vis-a-vis* the New Public Management era. These new trends have been accelerated by the global financial crisis that hit the countries included in the study. The common denominator of these trends is: saving on administration for the benefit of in-kind service delivery to the citizens and businesses. This implies not only shifting of resources but also building a simpler, more integrated, more compact administration, denoted in this study as a move towards “basic government”. The debate about this issue is discernible in all countries included in the study and started before the global financial crisis occurred. The reforms described in the final report have been selected on the basis of whether they fit into the new reform trends (next to the other criteria mentioned above). Reforms that run counter to these trends are omitted. It is true that reforms of the latter type gradually become rare in the countries participating in the study, but they still occur (for instance proportional across the board cuts). This way of selecting the reforms is intended to provide coherence to the final report that would otherwise be lacking.

Three periods of public administration

Receding government

The period of receding government is commonly associated with the Reagan administration in the US and the Thatcher cabinets in the UK, but there were many governments in other OECD countries that subscribed to similar ideas and policies. Much emphasis was put on the reduction of government tasks, particularly the tasks of central government by deregulation, privatisation, decentralisation, expenditure reduction and fiscal alleviation. The idea was that private sector growth and prosperity was hampered by excessively high taxes and expenditure levels. Theoretical underpinnings of these ideas were partly found in supply side economics and public choice theory. Supply side economics showed that essential incentives for growth in the private sector could be impaired by excessively high levels of taxation. Public choice theory showed that without strong legal constraints, the incentives motivating bureaucratic and political behaviour would lead to an ever expanding public sector that would eventually overwhelm the private sector of the economy.

New Public Management

During the nineties of the previous century, the organisation of government has been profoundly affected in all countries participating in the Value for Money study by the ideas of New Public Management.

It has often been observed that the ideas of New Public Management are rooted in two different frameworks of thought that are not always easily reconcilable. One is that of business administration and management. Many prominent business men and women have been invited in the 1980s and 1990s to participate in high level committees that had to advise governments on organisational reform. These consultants primarily brought practical experience in the management of large (private) organisations to the task. The other was the theoretical framework of institutional economics that had in the previous decades (the 1960s and 1970s) become prominent in academic circles.

The ideas of New Public Management have been described in many reports and publication with certain variations, but with a fixed core. The core includes:

- Separation of policy execution from policy development;
- Loosening standards of operational management (“let managers manage”);
- Steering and control of executive agencies on the basis of outputs;
- Budgeting on the basis of outputs (performance budgeting);
- Outsourcing of intermediate production to the market;
- Stimulating competition among service providers, by allowing private suppliers to provide publicly financed services.

Some of the ideas of New Public Management have been successful and have been adopted in many OECD countries. However, other reforms have led to unexpected and problematic consequences, such as undesired growth of administrative employment (“back office”) and de-motivation of professionals in in-kind service delivery (“front office”: care providers, teachers, police officials, etc.).

Basic government

Since the mid-2000s, a third period of public administration can be observed in which some of the New Public Management reforms are adjusted, revised or even abolished and in which new trends come to the fore. A common feature of these trends is that the government should focus more on service delivery and less on administration, in other words: more front office, less back office², or as the Danes say: “more warm hands, less cold hands”. This implies not only shifting resources from administration to in-kind service delivery, but also building a simpler, more integrated, more compact administration, denoted in this study as a move towards “basic government”. Some of the trends that fit into this picture and that are currently discernible in the countries participating in the Value for Money study are:

- Smaller core ministries focusing on policy development and policy evaluation;
- A more logical and transparent separation of tasks between central and local government;
- Better integration of executive and professional expertise in policy making (vertical integration);
- Sharing of process units and amalgamation of executive agencies (horizontal integration);

- Integration of supervisory and regulatory units (inspectorates) and risk based supervision;
- Support service sharing;
- Concentration of standard-setting for operational management (finance, human resources and organisation, information and ICT, procurement, communication, internal audit, accommodation real estate and facilities) in one or two ministries;
- Less politicians and political advisors at the top of ministries;
- Better and more professional financing of agencies focusing on the costs of required capacity (capacity budgeting).

Some of the new trends have become possible or have been accelerated by the development of ICT technology over the last few years. Yet, it would be slightly misleading to see in ICT the main characteristic of the post New Public Management era. This report makes the argument that the shift of emphasis towards in-kind service provision and its corollary that public administration has to be limited to its basic roles is the central feature of the new era in public administration.

Current trends are to a large extent a reaction to unexpected and problematic results of the reforms inspired by New Public Management. In this light it is useful to pay some attention to these results.

Problematic results of New Public Management

The problematic results of the New Public Management reforms can mostly be traced to the following causes:

a. Separation of policy execution and policy development has led to policies that are impossible to execute.

The expertise of officials who know the consequences of policies on the ground, in executive organisations and service delivery organisations is essential for policy development. The business processes in executive units and policy development units may be different, but the expertise of executive officials is indispensable for successful policy development. Insufficient involvement of executive and professional experts in policy development will lead to legislation and policy measures that are impossible to execute or that give rise to unexpected problems during execution.

b. Loosening of standards of operational management has led to cost increases

In any organisation, whether private or public, delegation of authority and accountability for results are two sides of the same coin. Delegation without accountability leads to chaos, accountability without delegation leads to paralysis. However, the autonomy granted to managers concerning the use of inputs cannot be unlimited, even if they are held accountable for outputs. Since agency managers and professionals are better informed about the costs of inputs and the hidden characteristics of outputs (asymmetric information), there is always room for discretionary profits on the side of agency managers and professionals (the principal-agent problem). Under these circumstances, constraints on inputs are indispensable, both in the financial sphere and in the sphere of other operational means (human resources, procurement, information and ICT, etc.). Operational standards that are too loose lead to cost increases all over government. This is particularly the case in executive organisations where standards were

loosened further than in core ministries. It is surprising that whereas New Public Management has clearly been inspired by certain results of institutional economics, these more subtle insights have been neglected.

c. Financing of agencies on the basis of output targets has led to loss of service quality and bureaucracy

The fundamental difficulties with financing on the basis of output targets are threefold:

1. Outputs are difficult to measure.

The main difficulty with the measurement of outputs is the heterogeneity of services³. For policy making divisions of ministries this is obvious, but for executive agencies less so. Even today, the idea that executive agencies, whether administrative agencies or service delivery units (police, defence, penitentiary institutions, schools, hospitals, cultural institutions, etc.) can be financed on the basis of output targets is omnipresent. Measurement requires pre-defined units of performance. This requirement colludes with the universal heterogeneity of services. Much of the frustration of the professionals in the police, the care sector, the schools, the army and the cultural sector is due to insufficient recognition of the heterogeneity of the services they are providing. This is not just a question of further refinement of output definitions. Quantitative indicators, however sophisticated, can never replace the quality standards to which professionals adhere. This is equally true, for that matter, in the market sector of the economy, but there nobody has proposed anymore since the demise of central planning in socialist states, to measure performance in terms of outputs. In the corporate sector of a market economy performance is measured in terms of contribution to profit, which is a different standard altogether, but one which is lacking in the public sector and for which there exists no viable substitute. Moreover, for the purpose of financing, as opposed to steering and control, there is no need at all for output measurement. Budgeting can be based, and is generally based, on more simple, robust indicators for output capacity and input costs. The emphasis on measurable outputs has generated an obsession with performance indicators among senior managers and the growth of entire new layers of middle managers who are interfering in the daily work of executive professionals in ways that are seen by the latter as bureaucratic, distortive and detrimental to service quality.

2. Output definitions are subject to permanent reformulation.

Outputs (services delivered) are a means to achieve outcomes desired by politicians, but outcomes are a mixed bag. In the area of health care, politicians want for instance: shorter waiting lists in hospitals or preservation of small hospitals in rural areas, and in the area of education: less segregation according to parental income, higher and more uniform educational level at the end of primary schooling. Furthermore, politicians have fundamentally different views on what constitutes good health care and good education. In government documents outcome formulations are often the result of political compromise, that do not excel in clarity. Moreover, the translation into output requirements is never straightforward. The relationship between outcomes and outputs (services delivered) is always open to discussion. Indeed this is the main subject of social research and evaluation of sectoral policies. Under these circumstances output definitions are inherently subject to continuous reformulation and change in the light of political developments and new insights from social research. The line minister is ultimately accountable to parliament and society for what he/she is trying to achieve and managers

in ministerial divisions and agencies should be willing and prepared to adjust their activities continuously in the light of ministerial directives.

3. What has to happen if output targets are not achieved?

New Public Management has never answered the question what has to happen if output targets are not achieved. Should the agency budget be cut by way of sanction, or should on the contrary the budget be increased because apparently the agency needs more resources to achieve its targets? Should sanctions be imposed on the agency management? In practice we see very few sanctions, but in theory sanctions are advocated and the threat of sanctions is always in the air. This perverse incentive leads to manipulation of the data (artificially lowered targets in order to decrease the risk of underperformance, choice of output indicators that are easy to meet but have nothing to do with the outcomes politicians are interested in, sometimes outright fraud with the numbers) and gaming behaviour (putting emphasis on activities that improve the data). No campaign to promote civil service values or public ethos can compensate for that, the less so if managers and professionals feel frustrated in their own right on how their performance is assessed. Everything we knew already about central planning in socialist states but now limited to the public sector of a market economy.

d. Budgeting on the basis of output targets has led to loss of control by Parliament and unreadable budget documentation.

New Public Management has not only promoted the idea that executive agencies could be financed on the basis of output targets, but that the entire budget process could be organised in this way: performance budgeting. As a consequence, the budget documentation was packed with output information and input information was removed. The difficulty with this reasoning is partly the same as mentioned above concerning the financing of agencies on the basis of outputs targets. When applied to the budget process as a whole this has led to complaints by parliamentarians about lack of transparency and loss of control.

However, there is also a more basic problem. This reasoning overrates the role of the budget process by conceiving it as the central steering mechanism of the government. However, more than 90% of expenditures is not decided in the budget process, but is entirely determined by existing laws and policies. These laws and policies are not decided in the budget process but in government decisions entirely independent from the budget process. The government and line ministers are responsible for these laws and policies vis-à-vis parliament and society at large. Obviously, the government and line ministers need information on results in order to develop and execute their programmes. Similarly, parliamentarians need such information to hold the government and line ministers to account. Accordingly, this information should be a normal component of the regular exchange between the government or line ministers and parliament⁴. However, there is no need for such information in the budget process. The budget process only serves to safeguard the ceilings for ministries and for the government as a whole and to (re)distribute at the margin (if there is anything to distribute) or to cut at the margin (if the ceilings are exceeded). In such decisions at the margin, output or outcome information sometimes plays a role. In those particular cases, where this is demonstrably the case in relation to concrete budgetary decisions, Parliament and citizens would obviously be interested to learn about such information. However, apart from this particular case, output and outcome data in the budget documents tend to obscure rather than clarify the information these documents are supposed to convey. The overrating of the budget

process as a central steering mechanism of the government may detract from its more basic role in the maintenance of budgetary discipline.

e. Outsourcing of intermediate production to the market has led to decrease of service quality and higher costs.

Outsourcing can lead to quality and efficiency gains if the external market is competitive. This basic insight of institutional economics has been taken over by New Public Management. However, in many cases markets for intermediate products are beset by serious imperfections. Outsourcing leads to transaction costs. These are rooted in specific assets and uncertainty. If an external supplier of the government must invest in specific assets (including expertise on government requirements), that cannot be used in sales to other customers, s/he must charge the full cost of these assets to the first product s/he sells to the government. The government would then lose the value of these assets if it would want to change of supplier (the “hold up” problem). Specific assets thus provide a certain degree of monopoly power to external suppliers. Moreover, external suppliers want a minimal degree of certainty about product specifications, which they want to be fixed in contracts. Since the government often changes its mind due to political developments, these contracts often have to be changed, which lead to additional costs. Again it is surprising that these more subtle insights from institutional economics have received little attention in New Public Management.

The need for consolidation as a driving factor

All current trends can in principle lead to savings on central government expenditures. This implies that they can also be used for deficit reduction. It implies too, that the global financial crisis has been a supportive factor. Although the new trends started before the global financial crisis hit, the crisis helped to carry out the reforms by lending them additional urgency.

The OECD study “Restoring Public Finances” (OECD, 2011), and its updated version (OECD, 2012) make clear that in reaction to the global financial crisis OECD countries announced consolidation plans for the period 2011-2015 amounting to 5% of GDP. Of the quantified measures around 25% consisted of cuts on operational expenditures (as opposed to programme expenditures)⁵. The need for consolidation has thus been an important factor in the drive towards the reform of public administration.

However, the justification of the reforms towards a simpler, more compact and more integrated public administration is neither dependent on the need to improve in-kind service delivery, nor on the need to reduce the deficit. These reforms are worthwhile on their own merit, since they lead to more efficiency in public administration. Political acceptance may become easier when the savings are used to improve service delivery or to reduce the deficit, but if it is plausible that these reforms do not harm the quality of public services, they should also be pursued for their own sake.

Tools of the study

Apart from the criteria to select the reforms, the study makes use of two special tools to analyse the reforms. These tools are a common language and common taxonomy of governmental tasks and organisations.

Any attempt at studying the organisation of government from an international perspective must cope with the large variety of institutions prevailing in different

countries and a bewildering diverse terminology to denote these institutions. The OECD member countries may be thought of as a more or less homogeneous group of countries that share certain basic features such as representative democracy, rule of law, market economy and robust social security arrangements, but the variety of institutions that have been established to safeguard these features is surprisingly large. Even among the thirteen countries that were invited to participate in the study in view of supposed similarity in institutional structure, the differences are enormous. This variety is the result of centuries of historical development, geographical circumstances, national values and political traditions.

Any description of a reform in a given country must necessarily refer to the prevailing institutions in that country. However, against the background of the variety of national institutions, this immediately poses the question of which conceptual apparatus and vocabulary should be used to describe and denote these institutions. Any term used in a national vocabulary for public administration has another meaning or connotation in the vocabulary of another country. One can think of such elementary terms as agency, ministry, department, policy execution, regulation, inspectorate, administration, civil service, etc. Under these circumstances the Value for Money study has opted for using existing terms, used in some countries, to denote roughly comparable institutions in other countries. This will surely be at odds with the national ways of speaking about these institutions, but unless an entirely new and artificial terminology would be developed, there is no alternative. An attempt is made to use the common terminology and definitions throughout the study. The definitions are provided in a separate glossary in an annex to the report. In addition specific terminology that is used only in reforms on a certain subject are provided and explained in the chapter on that subject. The development of this conceptual apparatus is seen as an important result of the study in its own right because it provides a basis for future comparative work in the area of public administration.

The Value for Money study makes use of a common taxonomy of governmental tasks and organisations. This taxonomy is based on a statistical survey of administrative employment that was developed in the Netherlands in the context of the Central Government Reform initiative and that is called “snapshot of the public administration”. The survey has the format of a table with four columns for tasks and three rows for organisations. Each cell of the table mentions the size of administrative employment working on each task in each organisation. The tasks distinguished in the snapshot are:

- policy development
- administrative policy execution
- administrative regulation and supervision
- support services.

The organisations are:

- core ministries
- arm’s length agencies
- independent agencies.

All concepts are defined within the universe of central government employment as defined in the national accounts. Snapshots have been produced for 11 countries participating in the study.

The snapshots are based on a strict distinction between administration and in-kind service delivery. The snapshots contain exclusively administrative employment. Administrative employment contains all employment for policy development: administrative regulation and supervision; support services; as well as the administrative part of policy execution (which includes for instance the tax office, the social security administrations, the units that take care of school financing, the units that pay subsidies, etc.). It excludes the High Colleges of State (Parliament, President's Office, Supreme Audit Institution, etc.); the Judicial Branch; and all employment in collective and individual service delivery. Service delivery includes the military; the police; the staff of penitentiary institutions; other collective service delivery units (for instance for infrastructure construction and maintenance); and all staff of educational institutions, health providers, and other institutions providing individual service delivery in kind.

The report is based on three sources of empirical information:

- Information from 3 questionnaires;
- Statistical information on employment and public expenditures;
- Information collected during missions to countries participating in the study.

In the period November 2009 – January 2010 three questionnaires were sent to the participating countries focused on statistical information about public employment and on recent reforms. The questionnaires were answered by 11 of the 13 countries participating in the study.

Statistical information used in the study is taken from the OECD national accounts, from the snapshots of the public administration and from the Public Finance and Employment database (PFED) of the OECD. The latter database was still in development during the drafting of the report, but could already provide a number of important data. The PFED contains data on public finance and public employment for all sub-sectors of general government (including central government) that are consistent with the national accounts and hence internationally comparable.

The OECD Secretariat conducted missions in five countries participating in the study, namely the countries for which assessments were made (Australia, Denmark, the Netherlands, Norway and Sweden). During each mission the Secretariat interviewed officials of the Ministry of the Interior or the Ministry of Public Administration, the Ministry of Finance, some other relevant ministries (often Economic Affairs and Foreign Affairs and some line ministries) and officials of a number of executive agencies and regulatory agencies.

Contents of the study

The study is organised in accordance with the snapshots.

Chapter 2 provides information on public employment making use of the distinctions that characterise the snapshots. In addition it provides employment data from other sources that are relevant for certain reforms described in the study as well as data on public expenditures and revenues.

Chapters 3 to 6 focus on the tasks of central government: policy development, administrative policy execution, administrative regulation and supervision and support services. The chapter on support services is integrated with information on operational management (including standard setting for operational management).

Chapters 7 to 10 focus on 4 areas of support services and operational management, namely finance, human resources, ICT and audit. Other areas of support services (procurement, accommodation, real estate and facilities, communication) could not be covered in this report (although important new developments are taking place in these areas as well).

Chapters 11 and 12 approach the organisation of central government from the angle of types of organisations. Chapter 11 looks at core ministries (under the heading of “Machinery of Government”) Chapter 12 looks at agencies, both arm’s length and independent agencies.

Since policy development mostly takes place in core ministries and policy execution mostly in agencies, the dividing line between the chapters on policy development and on machinery of government, and between the chapters on policy execution and on agencies, was not always clear cut. The dividing lines have been drawn in light of the basic thrust of the two angles (tasks and organisations) but in order to avoid overlap some themes have been attributed to either of the chapters concerned, whereas they are also relevant to the other. Political decision-making and the role of political appointees has entirely been relegated to Machinery of Government, the choice of organisational type and competition in service delivery has entirely been relegated to policy execution.

All chapters are structured in the same fashion, namely on the basis of reforms observed in one or more of the 13 countries of the study. Each section of each chapter starts with a short characterisation of the reform, followed by information on where and when it occurred. Subsequently the proposal is analysed in the national context of where it occurred. Information is provided on savings, effects on the quality of services and other consequences of the reform. Each section is concluded by some comment on the applicability of the reform in other countries (where it did not yet occur).

Annex I contains a list of all reforms included in the study with a qualitative indication of the size of potential savings.

Annex II contains the glossary.

Notes

1. Data for the study were partially collected through questionnaires held in 2009-2010. Statistical data from public sources were collected in 2012. The report has been drafted in 2013 and 2014. The report contains the most recent information available at the time that the data were collected and the report was drafted.
2. See for instance: *“Putting the front line first: smarter government”* (HM Government, 2009), the reform programme of the UK government of 2009 (under the Brown cabinet, but many

- elements of which have maintained under the current cabinet) and “Civil service reform agenda” (letter of the Minister of Housing and the Central Government Sector of the Netherlands to the House of Representatives of 22 May 2013).
3. Outputs include not only services in kind but also administrative services, such as the application of financial instruments and regulations in individual cases (see glossary).
 4. A separate question is what role (quantitative) performance indicators should play in this information, next to more qualitative forms of information such as policy evaluations. Interesting in this respect is the development in the UK. Traditionally there has been a strong emphasis in the UK on the role of the centre of government, in particular the cabinet office, in driving public sector performance, as opposed to role of the line ministries which is more prominent in coalition cabinets. However, since the Brown cabinet (“Putting the frontline first: smarter government”, UK Government, 2009) the number of central performance indicators has been drastically reduced in view of perverse effects and bureaucratic costs and under the current government this trend has continued.
 5. For the relation between these concepts and the concepts of administration and in-kind service delivery see glossary.

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Chapter 2

Statistics

This chapter provides statistical data about government employment and public expenditures and revenues in the participating countries.

Employment is divided over administrative employment and in-kind service delivery employment. Administrative employment is divided over the tasks of government and the types of government administration in accordance with the snapshot of the public administration. Government employment is presented in full time equivalents (FTEs) per 1 000 inhabitants and as a percentage of domestic employment. Differences between countries are analysed in connection with institutional arrangements, such as rates of decentralisation and organisation of health care and social services in the corporate or general government sector.

Expenditures are presented in a functional classification, called COFOG-Special. This classification resembles the COFOG classification of the National Accounts, but makes additional distinctions between collective and individual goods and between goods in kind and cash transfers. Differences between countries are analysed in connection with national spending priorities and institutional arrangements such as rates of decentralisation and of out-sourcing.

Revenues are divided in own revenues and other revenues and presented by sub-sector of general government (level of government).

Introduction

Criteria for data selection

This chapter will provide statistical data about the countries included in the study. These data concern two areas: employment and public finance (expenditures and revenues).

The data meet two criteria: they are internationally comparable and they are relevant for some of the reforms to be described.

In order for the data to be internationally comparable they have been taken, as much as possible, from international statistical sources. Data on public employment have been taken from Laborsta (the statistical office of the International Labour Organisation, ILO). Data on administrative employment have been taken from the snapshots of the public administration. These data were collected by a questionnaire that was sent out to the participating countries for this study¹. Data on expenditures and revenues have mostly been taken from the Public Finance and Employment Database (PFED) of the OECD. The PFED is itself based on the data from the OECD National Accounts and from Eurostat National Accounts.

Employment

The data on central government employment make distinctions between:

- administrative employment and in-kind service delivery employment;
- employment for the four tasks of government (policy development, policy execution, administrative supervision and regulation, support services);
- employment in the three types of government organisations (core ministries, arm's length agencies, independent agencies).

Administrative employment includes all employment except employment involved in in-kind service delivery. Service delivery includes:

- the military;
- the police;
- staff of penitentiary institutions (prisons, closed youth educational establishments, closed establishments for psychopaths);
- other collective, in-kind service delivery, for instance units for construction or management of transport infrastructure (roads, tunnels, bridges, waterways, harbours, rail networks, airports, pipelines, etc.) and ICT infrastructure (cables, ether frequencies, etc.);
- staff of all educational institutions, health providers and other institutions involved in individual service delivery (cultural institutions, institutions delivering social services, etc.);

It should be noted that according to these definitions payment of cash transfers (social benefits, grants) and of subsidies is not in-kind service delivery, but administration. Similarly, tax assessment and collection is not in-kind service delivery, but administration. Furthermore, decision-making on legal decrees in individual cases

(permits, licenses, concessions, admissions) is administration and not in-kind service delivery.

These definitions imply that of the four tasks of government three are exclusively administrative. Only policy execution can either be administrative or in-kind service delivery.

Furthermore, the universe of central government is defined in accordance with the national accounts. However, Social Security Funds are merged with the Central Government². Public non-profit institutions outside the State are included under independent agencies. The scheme of table 2.1 illustrates the relation between the government organisations and the split between administrative and in-kind service delivery employment. Some examples are provided in the footnotes. The heavy shaded area shows the total of administrative employment in central government³, the lightly shaded areas shows the total of in-kind service delivery employment in central government.

Table 2.1. Administrative and in-kind service delivery employment in the organisations of central government
(A = administration; S = service delivery in kind; X = does not occur)

	Core ministry	Arm's length agency	Independent agency with or without legal personality*
Policy development	A	X	X
Administrative supervision and regulation	A	A	A
Support services	A	A	A
Administrative policy execution	A	A	A ^a
Policy execution by service delivery in kind	S ^b	S ^c	S ^d

Note: * Independent agencies with administrative tasks may have or may not have legal personality. If they do, they are public non-profit institutions in the sense of the national accounts.

Footnotes:

a For instance: social security funds.

b For instance: armed forces.

c For instance: penitentiary institutions.

d For instance: public universities, museums, public theatres and art companies.

Expenditures and revenues

The data on government expenditures make distinctions between cash transfers and expenditures on goods in kind, as well as between expenditures on collective goods and on individual goods⁴. These data are available from the PFED. Furthermore, they are based on a functional classification that resembles the international COFOG classification (Classification of functions of government), which is called “COFOG Special”.

The COFOG-Special classification splits the expenditures of general government as follows:

Collective goods in kind

1. General governance services
2. Basic research
3. Defense
4. Public order and safety
5. Infrastructure and territorial development
6. Market regulation

Collective goods in cash

1. International co-operation
2. General purpose and block grants
3. Interest

Individual goods in kind

1. Non-market recreation, culture and religion
2. Social services
3. Health
4. Education
5. Market subsidies

Individual goods in cash

1. Social cash transfers

The classification is based on the cross-classification of second level regular COFOG and the economic classification (available at Eurostat for the European countries)⁵.

Government expenditures can also be divided in administrative expenditures and programme expenditures. This applies to each of the expenditure groups of COFOG-Special mentioned above as well as to total government expenditures (in general government and its sub-sectors).

Administrative expenditures include all operational expenditures (compensation of employees and intermediate consumption in the sense of the economic classification of the national accounts) of administrative units as defined above (see Table 2.1)⁶. Programme expenditures include all other expenditures: gross capital formation, property income, other current and capital transfers, subsidies and social benefits (in the sense of the national accounts), as well as expenditures for compensation of employees and intermediate consumption (operational expenditures) of the in-kind service delivery units as defined above (see Table 2.1).

The data on revenues have been taken from the PFED. The revenue part of the PFED is based on the OECD Revenue statistics as well as on the expenditure part of the PFED (for the transfers between levels of government)⁷.

Furthermore, the universe of central government is defined again in accordance with the national accounts. However, Social Security Funds are merged with the Central Government.

Basic statistics of the countries included in the study

The countries included in the study have many characteristics in common, but still, as highlighted in Chapter 1, the diversity is large. Table 2.2 illustrates the diversity on the basis of some basic demographical, geographical and economic statistics.

Table 2.2. Basic statistics of the countries included in the study (2011)

	Australia	Austria	Canada	Denmark	Finland	France	Ireland	Nether-lands	New Zealand	Norway	Spain	Sweden	UK	
Land and population	Area (km ² * 1000)	7692.0	8.4	9984.7	4.3	33.8	6.4	7.0	26.8	3.2	50.5	4.5	24.4	
	Population (millions)	22.3	8.4	34.5	5.6	5.4	63.2	4.6	4.4	5.0	46.2	9.4	63.3	
	Inhabitants per km ²	2.9	100.2	3.5	129.3	15.9	98.2	65.1	16.5	15.3	91.4	21.0	259.8	
Employment	Persons employed * 1000	11452.2	4143.9	17372.3	2729.7	2494.0	26445.2	1861.3	2225.0	2544.0	18106.7	n.a. ^a	29159.0	
	Full time equivalents * 1000	8518.6	3193.7	13544.8	2287.2	2036.0	22751.5	1302.2	1609.9	2174.5	14803.4	4025.8	21559.4	
GDP	GDP (USD *billion)	983.5	360.5	1386.9	233.0	208.0	2369.6	196.6	139.0	306.6	1483.2	394.6	2201.4	
	GDP per head (USD *1000)	43.2	43.0	40.2	41.8	38.6	36.4	42.9	31.5	61.9	32.2	41.8	35.1	
Fiscal indicators	General government expenditures (% of GDP)	36.3	50.8	41.0	57.7	55.2	55.9	47.1	49.5	43.9	45.7	51.5	48.0	
	General government revenues (% of GDP)	32.1	48.3	37.3	55.7	54.1	50.6	34.0	42 ^b	57.5	36.2	51.5	40.3	
	Net borrowing/lending requirement (% of GDP)	-4.2	-2.4	-5.6	-2.0	-1.0	-5.3	-13.1	-4.3	-7.5 ^b	+13.6	-9.6	0.0	-7.7
	Public debt (% of GDP)	43.9	79.8	109.9	59.9	58.6	99.2	102.3	76.2	35.4	33.9	78.2	49.2	46.2
Politics	Number of parties in (parliament, lower House)	9	8	5	8	8	17	9	9	7	14	8	10	

Notes: ^a Not available from the source; ^b 2010 as the latest year available in source.
Sources: CIA (2013), OECD (2013b).

Employment in general and central government

Employment in general government is strongly affected by:

- the degree of outsourcing of administration and in-kind service delivery;
- the organisation and financing of individual service provision in kind (health; culture, recreation and religion; education; social services) inside or outside the general government.

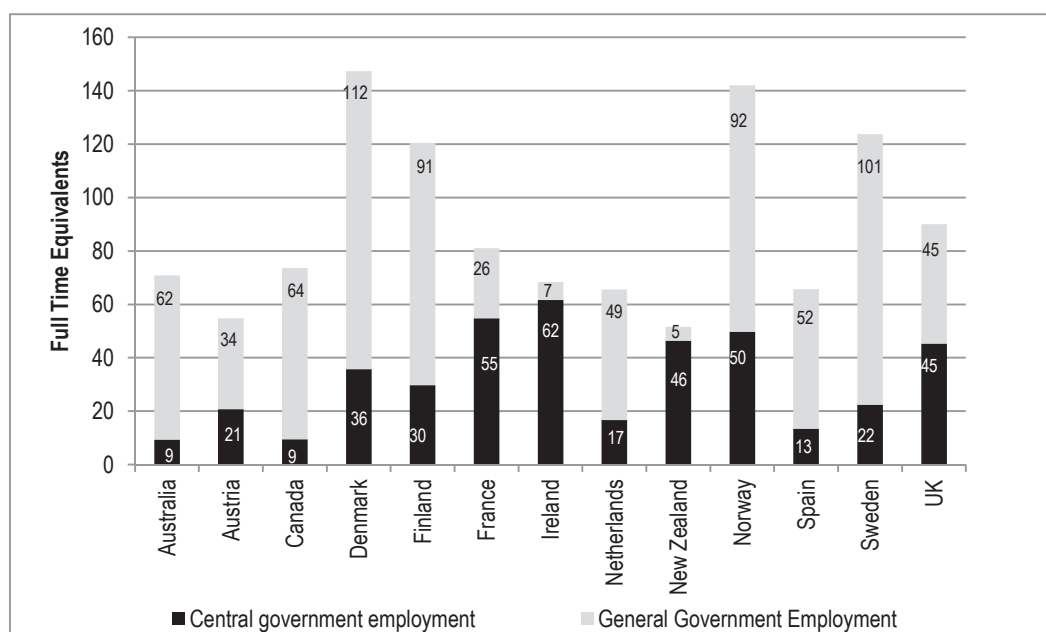
As shown below (under expenditures) rates of outsourcing differ substantially between countries. This directly affects government employment.

As to the organisation and financing of individual service provision in kind, there are substantial differences as well. An institution belongs to the general government sector if it is publicly financed and controlled. In the UK, France and the Nordic countries health and social services are largely financed and controlled by central and local government (apart from small privately financed and controlled sectors). In the Netherlands on the other hand these services are almost entirely controlled by the corporate sector (but equally collectively financed via social transfers). This strongly affects government employment as there are tens of thousands employees in these sectors. Furthermore the share of the privately controlled institutions in the cultural sector (museums, theatres, art companies) differs widely between countries.

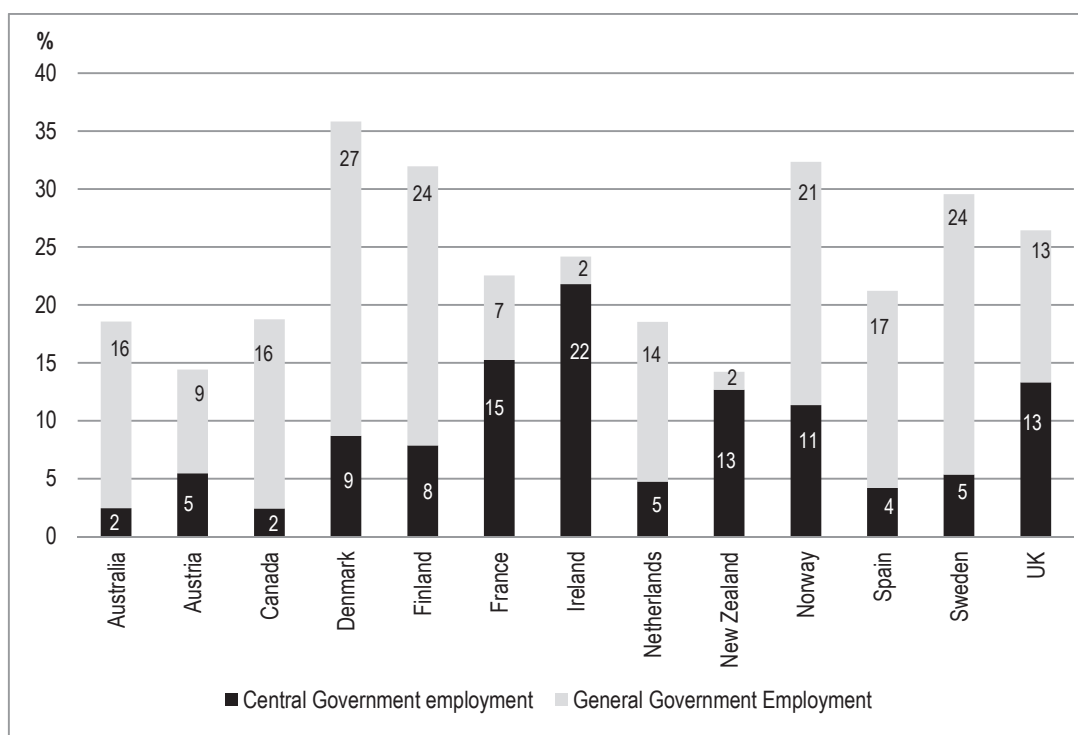
Furthermore, employment in central government is strongly affected by the degree of decentralisation of tasks. As shown below (under expenditures) the rates of decentralisation of tasks differ strongly between countries.

Figures 2.1a and 2.1.b provide a picture of the total size of employment in general and central government in the countries included in the study.

Figure 2.1a. Employment in general and central*government relative to population



Note: * Including social security. For Australia, Austria, Canada, Ireland, New Zealand, Norway, Spain and the UK, social security employment is included in the source under the level of government that provides it. For the other countries it is taken from the source and added to central government employment.

Figure 2.1b. Employment in general and central government relative to domestic employment

Sources: CG and GG employment: ILO (2013); for Australia: Australian Bureau of Statistics (2013), for Canada: Statistics Canada (2013), for France: OECD (2012); for Austria, the Netherlands and New Zealand the source provides the data in full time equivalents (FTEs); for the other countries the source provides employment in persons employed. These numbers have been transposed into FTEs by the methodology described in the Manual PFED, page 16 (Kraan et al., 2012); for Australia, Canada, Ireland and Norway FTE conversion coefficients have been calculated from different sources: for Australia, Ireland and Norway: OECD (2013b), (average usual weekly working hours worked on main job for total employment, divided by average usual weekly working hours worked on main job for full time employment); for Canada: Statistics Canada (2013) (average usually worked hours by full time employee in 2013, divided by weekly hours of hourly paid employees in public administration in 2009). Latest available General Government (GG) and Central Government (CG) in source for Austria: 2009; for Norway, Sweden and the UK: 2010; for France: 2006. Source for population and domestic employment in FTE: OECD (2013b) and OECD (2013a).

The differences between the countries seem to be very large, but can to a large extent be explained by the organisation of health care and social services (youth care, care for the elderly and social work). These services are largely organised in the general government in the Nordic countries, France, Ireland, Spain, Sweden and the UK, whereas they are largely organised in the corporate sector (but similarly largely funded by government) in Australia, Austria, Canada, the Netherlands and New Zealand. In the latter countries the general government share in domestic employment is lower than 20% and the general government employs less than 80 government FTEs per 1 000 inhabitants, whereas in the former countries the general government share in domestic employment is higher than 20% and, with the exception of Ireland and Spain, the general government employs more than 80 FTEs per 1 000 inhabitants.

Within this general picture, France, Ireland and Spain stand out as countries with a relatively small general government sector in spite of the fact that health care and social service are largely inside general government. Among the countries that have organised health care and social services in the corporate sector, Austria and New Zealand stand out as countries with a relatively small general government sector.

As to the size of the central government, the picture among countries with government provision of health care and social services is determined by the level of government in which these services are organised. In the Nordic countries this is the level of local government, in France, Ireland, and the UK this is the central government. Among the countries where health care and social services are not organised in central government (but either in the corporate sector or local government), Australia, Canada, the Netherlands and Spain stand out as countries with a relatively small central government (less than 5% of domestic employment, less than 20 FTEs per 1000 inhabitants). Of the latter four countries, the central government in the Netherlands is somewhat larger than in Australia, Canada and Spain, but the latter are federal countries, which may largely explain their small central government.

Among the countries where health care and social services are organised in the central government (France, Ireland and the UK), the size of central government employment is roughly similar in France and the UK (around 15% of domestic employment and around 50 in FTEs per 1 000 inhabitants), but substantially larger in Ireland (more than 20% of domestic employment, more than 60 in FTEs per 1 000 inhabitants).

Table 2.3 provides an overview of employment by levels of government (sub-sectors of general government).

Table 2.3. Employment by levels of government (2011)
(percentage of general government employment)

	Australia	Austria	Canada	Denmark	Finland	France	Ireland	Netherlands	New Zealand	Norway	Spain	Sweden	UK	Average*
Central government**	53.6	38.0	12.9	24.3	24.6	67.7	90.2	25.9	89.0	35.0	19.7	18.1	50.4	42.3
State government	41.0	41.0	48.2								58.7			14.5 (47.2)
Local government	5.4	21.0	38.9	75.7	75.4	32.3	9.8	74.1	11.0	65.0	21.6	81.9	49.6	43.2
General government	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Notes: *Average for the state government is calculated by setting state government employment for unitary states at zero. The true average for the federal states is added between brackets; ** Including social security. For Australia, Austria, Canada, Ireland, New Zealand, Norway, Spain and the UK, social security employment is included in the source under the level of government that provides it. For the other countries it is taken from the source and added to central government employment.

Sources: ILO (2013); for Austria: State Secretariat for Public Service (2010); for Australia: Australian Bureau of Statistics (2013); for Canada: Statistics Canada (2013); for the UK: Office for National Statistics (2013).

There are large differences between the size of central government employment as share of general government employment. The most important distinction is between unitary and federal states. Of the countries included in the study the federal states are: Australia, Austria, Canada and Spain. The average share of state government in federal states is 47.2 %, which is almost half of general government employment. Accordingly the share of central (federal) government in Canada and Spain is relatively small (less than 20% of general government employment). In Austria it is not small (38%), but still less than average (which is 42.3%). In Australia, on the other hand it is substantially

larger than average (53.6%). Australia has a very atypical distribution of employment over levels of government: a very large central (Commonwealth) government, a large state government level (at 41.0% only slightly lower than average) and almost no local government (5.4%, whereas the average is 43.2%). This suggests that Australia, although it is a federal state, is still very centralised, with almost no role for local government.

Of the unitary states, the Nordic countries have relatively small central government employment (below 25%) except Norway, which has 35%. The Netherlands has slightly more (25.9%) but fits into the same pattern, in particular in view of the fact that health care and social services are in the Netherlands outside the general government (which automatically increases the share of central government vis-à-vis the Nordic countries by the denominator effect). France (67.7%), the UK (50.4%) and in particular Ireland (90.2%) stand out as countries with large central governments. In the cases of France and the UK, this is largely explained by the fact that health care and social services are provided in these countries largely at the central government level. However, Ireland is atypical in the very small size of local government (9.8%), like Australia.

Table 2.4 provides some clues about the size of administration as opposed to in-kind service delivery in central governments. This distinction is at the heart of the concerns of the current study, which aims to assist government in their efforts to reduce administration (“back office”) to the benefit of in-kind service delivery (“front office”) and deficit reduction. Table 2.4 provides some data based on the definitions mentioned above (making use of the snapshots of the public administration). The data have to be interpreted with some care, since the countries reported numerous difficulties when reporting the snapshot data and may not have always interpreted the guidelines for the snapshot in the same way. Nevertheless the data are interesting.

Table 2.4. Central government*employment by administrative and in-kind service delivery employment (2009)

	Australia	Austria	Canada	Denmark	Finland	France	Netherlands	Norway	Spain	Sweden	Average
Administration	55.8	16.2	11.0	88.5	32.5	82.0	47.0	19.9	47.3	53.1	45.3
In-kind service delivery**	44.2	83.8	89.0	11.5	67.5	18.0	53.0	80.1	52.7	46.9	54.7
Total central government	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Notes: * Including social security. For Australia, Austria, Canada, Ireland, New Zealand, Norway, Spain and the UK, social security employment is included in the source under the level of government that provides it. For the other countries it is taken from the source and added to central government employment; ** Including employment in High Colleges of State (Royal or Presidential Household, Parliament, Supreme Audit Institution and Judiciary) and their staff, since these officials were excluded from the definition of administrative employment.

Sources: Administration: snapshots of the public administration 2009; Australia and Sweden: latest available snapshots 2008; for Ireland, New Zealand and the UK no snapshots are available; total central government: ILO (2013); for Australia: Australian Bureau of Statistics (2013); for Austria: State Secretariat for the Public Service (2010); for Canada: Statistics Canada (2013); for France: OECD (2012), latest available data from the source 2006; for the UK: Office for National Statistics (2013).

The largest components of in-kind service delivery at the central government level are health care and social services for those countries that have organised these services inside central government (France⁸) and the military (the data only contain the professional armed forces, not conscription). The latter component may to some extent explain the above average service delivery shares (and the consequent below average administration shares) in Austria, Canada, Finland and Norway. However, other countries have relatively large professional armed forces as well, and they still have above average administration shares: Australia, France and Sweden. Of the latter countries in particular France stands out: in spite of health care and social services being organised in the central government and maintaining a large armed forces, its share of administration in central government employment is the highest of all countries in the sample. Denmark is another special case: admittedly the size of its army is relatively small compared to other Nordic countries, but this does not seem to explain the very high share of administration (more than twice that of Finland, more than four times that of Norway, one and half times that of Sweden). The Netherlands and Spain have organised health care and social services outside the central government and maintain moderate armed forces. Their share of administration (and in-kind service delivery) is about average.

Table 2.5 presents an overview of central government employment by type of tasks as distinguished in the snapshots of the public administration.

**Table 2.5. Central government*administrative employment by type of activity (2009)
(Percentage of total administrative employment in FTE)**

	Australia	Austria	Canada	Denmark	Finland	France	Netherlands	Norway	Spain	Sweden	Average **
Policy development	18.5	15.0	72.6	5.1	8.5	86.8	7.8	9.0	18.3	2.8	10.6
Administrative policy execution	31.5	48.7		88.8	68.5		79.9	57.4	68.1	73.0	64.5
Administrative supervision/regulation	17.0	13.8		9.1	4.9		7.0	5.7	27.5	0.5	0.2
Support services	33.0	22.5	18.3	1.1	16.1	13.2	6.6	6.1	13.1	24.0	15.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Notes: *Including social security; **Averages are calculated by setting non available data at zero. The number between brackets is the true average for the countries for which data are available. Canada and France are excluded from the calculation of averages of policy development and administrative policy execution. France is also excluded from the calculation of the average of administrative supervision/regulation.

Source: Snapshots of the public administration 2009; Australia and Sweden: latest available snapshots 2008; for Ireland, New Zealand and the UK no snapshots are available.

Again, the caveat applies that the snapshot data have to be interpreted with some care. It should be kept in mind that the snapshots only contain administrative employment (not in-kind service delivery; consequently policy execution in the snapshots refers exclusively to administrative policy execution, for instance applying financial instruments subsidies, grants, social benefits, taxes, etc.) and regulations in individual cases.

Some results can be highlighted. In Australia, Austria and Spain a relatively large share of administrative employment works on policy development (more than 10% of total administrative employment). In Australia, Austria and Norway a relatively large share of administrative employment works on administrative supervision and regulation (more than 10% of total administrative employment, in Norway even more than 25%). In Australia, Austria, Canada, Finland and Sweden a relatively large share of administrative employment works on support services (more than 15% of total administrative employment, in Austria and Sweden more than 20% and in Australia even more than 30%). Administrative policy execution differs widely between countries, with Denmark, the Netherlands and Sweden at the high side (more than 70% of total administrative employment) and Australia and Austria at the low side (less than 50% of total administrative employment).

Table 2.6 provides an overview of central government employment by types of organisation as distinguished in the snapshots of the public administration.

**Table 2.6. Central government* administrative employment by type of organisation (2009)
(percentage of total administrative central government employment in FTE)**

	Australia	Austria	Denmark	Finland	Netherlands	Norway	Spain	Sweden	Average
Core ministries	42.0	29.7	6.2	10.4	43.2	8.7	36.1	4.2	22.6
Arm's length agencies	58.0	47.3	80.5	80.8	21.7	86.8	63.3	95.6	66.8
Independent agencies	0.0	23.0	13.3	8.7	35.1	4.5	0.6	0.2	10.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: * Including social security.

Sources: Snapshots of the public administration 2009; Australia and Sweden: latest available snapshots 2008; for Ireland, New Zealand and the UK no snapshots are available. For Canada the snapshot does not provide the split over types of agencies.

Once more, the caveat concerning the quality of the snapshot data applies. The table shows that the Nordic countries have moved most tasks out of the core ministries to arm's length and independent agencies (in practice mostly executive, supervisory and regulatory and support service tasks, not policy development tasks). In these countries core ministries currently employ less than 11% of total administrative employment. The Netherlands would fit into the Nordic pattern if the tax service were put in an arm length agency (in that case not more than 20.8% of administrative employment would remain in the core ministries in that country).

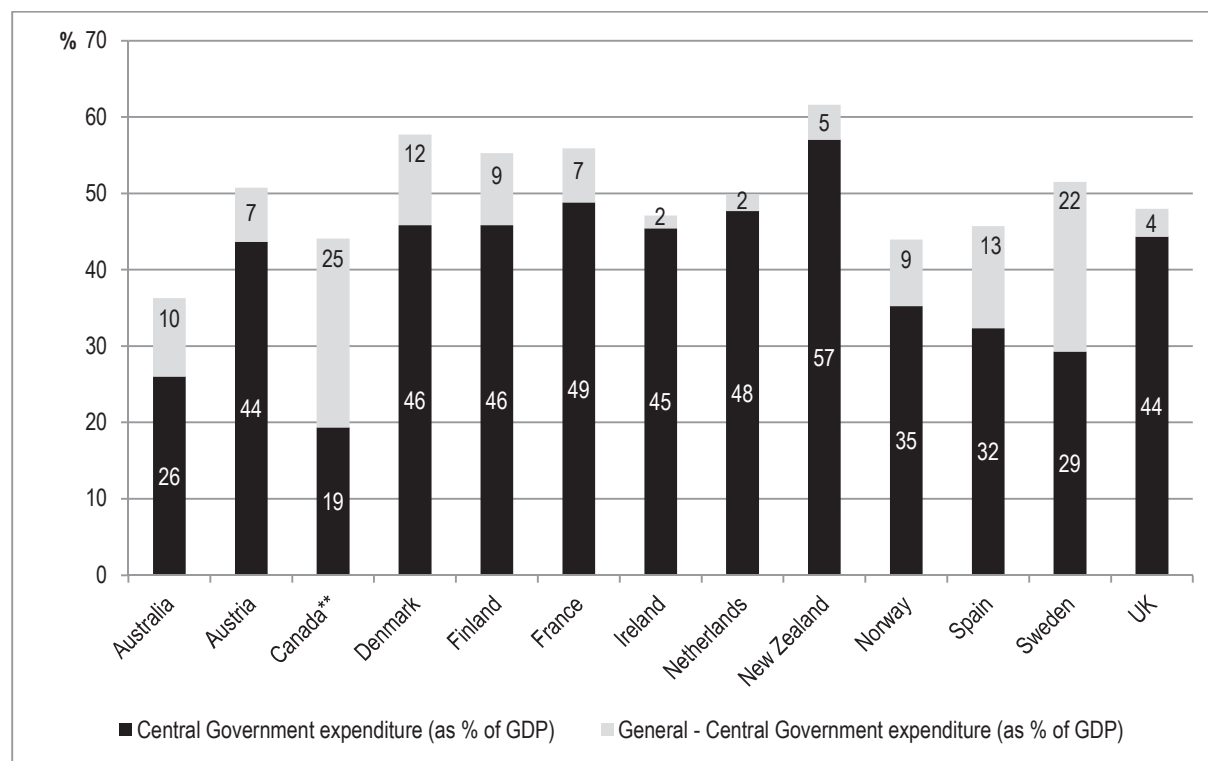
The other countries maintain larger core ministries. However, the data show that on average close to 80% of administrative employment in the sample countries is currently located in agencies.

Austria and the Netherlands stand out in that they employ a relatively large share of administrative personnel in independent agencies (more than 20%, in the Netherlands even more than 35%).

Expenditures and revenues in general and central government

The size of government expenditures varies substantially between the countries included in the study. Figure 2.2 provides a picture of total general and central government expenditures in relation to GDP.

**Figure 2.2. General and central* government expenditure relative to GDP (2011)
(percentage of GDP)**



Notes: * Including social security. For Australia, New Zealand, Norway and the UK, social security expenditure is included in the source under the level of government that provides it. Transfers between central government and social security funds are excluded; ** Data for Canada are from 2010.

Sources: OECD (2013b); Statistics New Zealand (2013).

Among the countries included in the study, there are six with general government expenditures over 50% of GDP: Austria, France, New Zealand and the Nordic countries except Norway. It should be noted that, in contrast to the size of employment, this result is not determined by the organisation of health care and social services, since also in those countries where these services are provided in the corporate sector, they are largely financed by social security funds or by the central, state or local government, which are included in the general government. There seems to be a correlation between the organisation of health care and social services inside the general government and high expenditures: France and the Nordic countries except Norway have organised these services in the general government and also spend more than 50% of GDP on the general government. However, Austria and New Zealand have organised health care and social services in the corporate sector and still spend above 50% of GDP on general government, suggesting that these countries spend more on other public services. The only country included in the study that spends less than 40% of GDP on general

government is Australia. All the others fall in between (spending between 40% and 50% of GDP on general government).

As far as central government is concerned New Zealand stands out as the only country where the central government spends more than 50% of GDP. This can partly be explained by its very small local government spending, but not entirely, since general government expenditure is also the highest of all countries included in the study and other countries with similarly small local government spend less (Ireland, the Netherlands, UK).

Australia, Canada and Sweden spend the least on central government (less than 30% of GDP). In the cases of Australia and Canada this can partly be explained by the fact that these are federal countries, but not fully, because there are other federal countries with much higher central government spending (Austria, Spain). Moreover, in the case of Australia, lower central government spending is not balanced by higher state or local spending since Australia also spends the least on general government. In Sweden the strong decentralisation plays a role, not only concerning health care and social services but also other services. Decentralisation in Sweden is much stronger than in other Nordic countries.

Apart from New Zealand (more than 50% of GDP), Australia and Canada (less than 30% of GDP), the countries included in the study fall in two groups: on the one hand Norway and Spain (between 30% and 40%) and on the other hand Austria, Denmark, Finland, France, Ireland, the Netherlands and the UK (between 40% and 50%).

In Spain the relatively low spending on central government can largely be explained by the fact that it is a federal country (with high spending at the level of state government). Norway has the smallest central government expenditures of all Nordic countries, although local government spending is similar to the other countries (including health care and social services).

The relatively large size of central government spending in Austria, Denmark, Finland, France, Ireland the Netherlands and the UK, is only in the cases of Ireland, the Netherlands and the UK compensated by a small local government (or state government) spending. In the other cases it leads to a high general government spending (higher than 50% of GDP). The small local government spending in the Netherlands is largely appearance: local government in the Netherlands is for more than 90% financed by central government grants, which are not excluded in Figure 2.2 from central government spending.

Table 2.7 provides an overview of spending by levels of government (sub-sectors of general government) as a percentage of general government spending. In this table transfers between levels of government are excluded so that the percentages of the sub-sectors count up to 100.

Table 2.7. General government expenditures by level of government (2011)
(percentage of general government expenditure)

	Austria	Canada	Denmark	Finland	France	Ireland	Netherlands	New Zealand	Norway	Spain	Sweden	United Kingdom	Average
Central government*	69.2	33.6	37.2	59.6	79.4	88.2	67.2	90.3	66.4	53.4	51.2	73.3	64.1
State government	17.0	46.7								34.3			8.1 (32.7)
Local government	13.9	19.8	62.8	40.4	20.6	11.8	32.8	9.7	33.6	12.3	48.8	26.7	27.8
General government	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: * Including social security. For Australia, New Zealand, Norway and the UK, social security expenditure is included in the source under the level of government that provides it.

Source: OECD (2013b); local government is included in state government for Australia. Transfers between levels of government are excluded.

France, Ireland, New Zealand and the UK are the most centralised countries included in the study (central government share in general government spending higher than 70%, Ireland and New Zealand even higher than 80%). For all these countries, the central provision of health care and social services is again an important cause, but it is not the only factor, since Australia, Austria, the Netherlands, and Spain also finance these services (partly) at the central level, but have substantially lower centralisation rates.

Canada and the Nordic countries, except Norway, belong to the most decentralised countries (central government share in general government spending below 60%, in Denmark and Canada even below 40%). For the Nordic countries the decentralisation of health care and social services spending is again an important cause. For Canada it is partly but not fully explainable by the fact that it is a federal country because Australia, Austria and Spain are also federal countries and they have a substantially higher centralisation rate (Australia and Austria above 60% and Spain above 50%).

The Netherlands and Norway take an intermediate position, together with Australia, Austria and Spain (central government share between 60% and 70% of general government spending). Since transfers between levels of government are excluded from this table, it now appears that the Netherlands now belongs to the intermediate group (whereas in Figure 2.2 the Netherlands seemed very centralised).

Table 2.8 provides an overview of central government spending by policy areas, divided by spending on services in kind and in cash and spending on collective and individual services.

Table 2.8. Central government¹ expenditure by policy areas (2011)
(percentage of central government expenditures)

	Austria	Denmark	Finland	France	Ireland	Netherlands	Norway	Spain ²	Sweden	United Kingdom ³	Average
General governance services	1.7	2.9	2.1	2.9	2.3	2.2	2.9	1.5	3.5	7.7	3.0
Basic research	0.7	1.9	1.3	0.5	0.0	0.6	0.1	0.3	2.6	0.0	0.8
Defence	1.6	3.0	3.3	3.8	0.9	2.8	4.5	3.2	4.2	5.8	3.3
Public order and safety	3.0	2.3	2.8	2.9	3.5	4.0	2.3	3.6	3.4	4.3	3.2
Infrastructure and territorial development	3.0	1.2	3.0	1.3	4.0	3.7	3.8	2.7	5.0	5.0	3.3
Market regulation	5.0	3.1	11.8	3.5	16.4	5.4	4.4	3.5	2.5	12.2	6.8
Total collective services in kind	15.0	14.5	24.3	14.9	27.0	18.7	18.0	14.8	21.1	34.9	20.3
International co-operation	2.4	5.5	3.0	1.5	2.1	2.7	2.9	2.9	4.8	2.4	3.0
General purpose and block grants	0.0	24.3	2.9	4.3	1.0	7.7	14.6	29.4	9.0	0.1	9.4
Interest	5.6	3.7	3.1	4.9	7.0	3.6	1.9	5.1	2.7	4.1	4.2
Total cash transfers	7.9	33.6	9.0	10.7	10.1	14.0	19.4	37.5	16.6	6.6	16.6
Total collective services and transfers	23.0	48.1	33.2	25.6	37.2	32.7	37.4	52.3	37.7	41.6	36.9
Health	12.9	0.2	2.6	16.5	15.0	18.9	14.4	1.1	3.2	17.6	10.2
Non-market recreation, culture and religion	0.6	0.5	0.8	0.6	0.6	0.2	0.8	0.3	0.9	0.7	0.6
Education	7.8	9.2	9.3	8.7	10.6	9.8	5.1	0.5	5.1	5.9	7.2
Social services	12.6	30.1	12.5	6.6	3.5	7.0	2.8	0.8	13.9	5.2	9.5
Market subsidies	3.7	2.7	2.9	1.6	0.9	2.2	3.9	1.7	2.5	0.9	2.3
Total individual services in kind	37.6	42.7	28.0	34.1	30.4	38.1	27.1	4.4	25.6	30.3	29.8
Social cash transfers	39.4	9.2	38.8	40.3	32.4	29.2	35.5	43.2	36.7	28.1	33.3
Total cash transfers	39.4	9.2	38.8	40.3	32.4	29.2	35.5	43.2	36.7	28.1	33.3
Total individual services and transfers	77.0	51.9	66.8	74.4	62.8	67.3	62.6	47.7	62.3	58.4	63.1
Total central government	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: ¹ Including social security; For Australia, New Zealand, Norway and the UK, social security expenditure is included in the source under the level of government that provides it. For the other countries it had to be added to the expenditures of central government; ²Latest data available: 2010; ³Latest data available: 2009

Source: OECD (2013c)

On average the central governments of the countries included in the study spend 20% of their revenues on collective goods in kind (mostly defence, police, infrastructure and industrial policy), 17% on collective cash transfers (mostly grants to state and local

government), 30% on individual goods (mostly health care and education), and 33% on social cash transfers (mostly old age and disability pensions and family benefits).

Some highlights of the table are:

- Denmark and Sweden stand out by high spending on basic research.
- France, Norway, Sweden and the UK stand out by high spending on defence.
- The Netherlands stands out by high spending on public order and safety (mostly police).
- The UK stands out by high spending on infrastructure and territorial development.
- Finland, Ireland, and the UK stand out by high spending on market regulation (mostly industrial policy);
- Denmark and Spain stand out by high spending on general purpose and block grants (mostly to the regions and the municipalities).
- Ireland and Spain stand out by high spending on interest.
- Among the countries that finance health care at the central level (all countries except Denmark, Finland, Spain and Sweden), France and the Netherlands stand out by high spending.
- Ireland and the Netherlands stand out by high spending on education.
- Austria, Denmark, Finland, and Sweden stand out by high spending on social services.
- Austria stands out by high spending on subsidies.
- Austria, Finland, France and Spain stand out by high spending on social cash transfers (pensions, disability benefits, family benefits, unemployment benefits).

Table 2.9 shows the outsourcing rates per policy area, which are an important explanatory factor for employment. The outsourcing rate is defined as the share of intermediate consumption in total expenditure per policy area.

**Table 2.9. Central government¹ outsourcing rates by policy areas (2011)
(percentage of total expenditure by policy area)**

	Austria	Denmark	Finland	France	Ireland	Netherlands	Norway	Spain ²	Sweden	United Kingdom ³	Average
General governance services	35,7	32,9	49,5	12,4	29,1	41,1	41,3	29,3	26,7	9,9	30,8
Basic research	29,7	37,8	35,4	19,4	0,0	30,8	3,8	36,9	33,2	81,2	30,8
Defence	28,0	45,5	58,4	36,1	18,0	38,2	42,0	36,9	63,7	55,2	42,2
Public order and safety	20,6	29,4	32,4	16,9	21,5	18,1	27,7	12,5	34,0	38,9	25,2
Infrastructure and territorial development	11,9	31,6	41,5	11,7	13,3	21,2	27,1	3,4	35,6	11,2	20,9
Market regulation	25,7	35,8	9,6	21,0	8,8	23,7	31,1	18,0	32,9	16,6	22,3
Total collective services in kind	23,5	36,1	27,6	21,5	13,1	26,5	34,0	19,5	38,9	23,5	26,4
Health	3,1	1,2	2,5	13,4	21,4	3,5	16,5	1,8	0,2	46,4	11,0
Non-market recreation, culture and religion	23,4	22,4	8,2	15,3	30,9	5,1	8,9	29,9	16,7	23,1	18,4
Education	11,8	23,5	9,5	4,7	7,2	2,5	22,8	6,8	19,3	7,6	11,6
Social services	2,6	0,6	9,8	14,6	29,2	7,5	12,1	1,5	3,8	5,6	8,7
Market subsidies	0	0	0	0	0	0	0	0	0	0	0
Total individual services in kind	4,7	5,8	5,1	10,8	16,9	3,8	14,6	3,5	6,5	30,0	10,2

Note: ¹ Including social security. For Australia, New Zealand, Norway and the UK, social security expenditure is included in the source under the level of government that provides it. For the other countries it had to be added to the expenditures of central government. ²Latest data available: 2010; ³Latest data available: 2009

Source: OECD (2013c)

Some highlights of the table are:

- The UK stands out by outsourcing 80% of its government financed basic research (contract financing research institutions in the corporate sector, rather than programme financing of public research institutions).
- Finland, Sweden and the UK stand out by high outsourcing in defence (maintenance of weapon systems, means of transport, etc.);
- Finland, Sweden and the UK stand out by high outsourcing in public order and safety (police equipment, prison security, etc.);
- Denmark, Finland and Sweden stand out by high outsourcing in infrastructure and territorial development.

- Denmark, Norway and Sweden stand out by high outsourcing in market regulation (facilities for the business sector, such as export information services, agricultural information services, etc. being organised in the corporate sector).
- Countries that stand out in outsourcing of collective in-kind service provision are the Scandinavian countries: Denmark, Norway and Sweden (not Finland).
- Outsourcing rates in individual in-kind service provision are hard to compare because the tasks of central government in these areas (health, non-market recreation, culture and religion, education, social services) are different. For instance Ireland and the UK have a high outsourcing rate in health. However, in these countries health care is mostly organised inside central government, so that outsourcing refers to the use of private care providers. In other countries, health expenditure by central government refers mostly to research and administration, which give outsourcing an entirely different significance.

Statistics on the split between administrative expenditures and programme expenditures cannot be provided because the administrative and in-kind service delivery components of compensation of employees and intermediate consumption are not available in any database. However, some countries are making the split, or a split that is quite similar to it in their national budgets or in the budget documentation (for instance the Netherlands, see further Chapter 7).

Table 2.10 shows some data on revenues; in particular the share of own tax revenues by level of government. Own tax revenues include direct and indirect taxes, but exclude social contributions, current and capital transfers and non-tax, non-grant revenues (sales and fees, property income and subsidies). Own taxes include shares in a tax sharing arrangement even if the tax-rate or the tax-base cannot be set by the government that is entitled to the share⁹.

Table 2.10. Own tax revenue as share of total revenue by sub-sector of general government (2010)(percentage of total revenue)

	Austria	Canada**	Denmark	Finland	France	Ireland	Netherlands	New Zealand**	Norway	Spain	Sweden	United Kingdom	Average
Central government*	81.1	91.0	82.4	72.6	91.1	86.3	81.7	84.1	76.4	85.3	81.3	95.7	84.1
State government	50.8	58.6								44.0			12.8 (51.2)
Local government	66.9	39.4	35.8	46.2	36.7	17.5	10.8	56.7	41.1	45.7	62.7	14.7	39.5

Note: * Including social security; **Latest data available: 2009

Source: OECD (2013c)

The most interesting conclusion from the table is the large diversity in the own-tax share of local government revenue, ranging from less than 15% (the Netherlands and the UK) to more than 60% (Austria, Sweden). This reflects largely deviating practices of funding local government, in particular concerning the use of central government earmarked and non-earmarked grants.

Notes

1. Data on administrative employment are not collected by any international organisation. The closest approximation is ISIC group O: Public Administration and Defense; compulsory social security, available at the Laborsta database of the International Labour Organisation (ILO). However, these data contain defense, which is conceived in this study as collective service delivery as well as the High Colleges of State, which are excluded from administrative employment in the snapshots of the public administration.
2. The System of National Accounts (SNA) makes it possible to distinguish Social Security as a separate sub-sector general government. The European System of Accounts (ESA) requires the separation of Social Security Funds from central government.
3. In accordance with the definition above this excludes employment in the High Colleges of State.
4. The split between individual and collective goods is based on the non-excludability criterion (in the sense of factual non-exclusion, not impossibility of exclusion). In order to maintain international comparability, a pragmatic approach is followed: mostly publicly funded goods that are freely accessible according to normal practice in most OECD countries are considered as collective, even if (parts) of them are not freely accessible in some OECD countries (publicly funded toll roads are thus considered as collective goods). The System of National Accounts (SNA) follows the same approach. In practice the PFED follows the SNA split and is fully consistent with the SNA in this respect. The methodology of the split between individual and collective goods is explained in the Manual of the PFED (Kraan, et al., 2012).
5. The methodology for the calculation of COFOG-Special is explained in the Manual of the PFED (Kraan et al., 2012).
6. Strictly speaking this is the definition of current operational expenditure. Administrative units have also administrative capital expenditure, namely investments in government buildings and equipment. It is somewhat misleading to consider these investments as programme expenditures, such as investments in infrastructure. However, this distinction is generally ignored. This sometimes leads to false conclusions, for instance, if high levels of public investment are seen as a positive aspect of the pattern of public expenditure. However, since no good data are available about the split of public investment over administrative and programme investment, the current study conforms to the convention to exclude administrative investment from the definition of operational expenditure (with this caveat).
7. The methodology for the calculation of the revenue statistics is explained in the Manual of the PFED (Kraan et al., 2012).
8. Ireland and the UK have also organised health care and social service inside the central government, but these countries have not provided snapshots of the public administration.
9. The dividing line between non-earmarked general purpose grants and tax sharing is not always straightforward. After much discussion, the OECD Network on Fiscal Relations across Levels of Government has defined tax sharing as follows: a financial flow from central to sub-national government is considered as tax sharing if it fulfils the following three criteria: *i*) risk sharing (for revenue yields); *ii*) un-conditionality (no earmarking); and *iii*) formula stability (no volatility of the formula from year to year).

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Chapter 3

Policy development

This chapter presents a number of recent reforms that aim at strengthening the capacity of central government for policy development. The chapter focuses on technical skills required for policy development, such as forecasting, analysis and evaluation, that were somewhat neglected in the era of New Public Management.

Several reforms aim to strengthen the capacity of line ministries in the areas of analysis, use of research data and policy evaluation, including forms of ex ante evaluation such as Cost Benefit Analysis (CBA) and Regulatory Impact Analysis (RIA). Another reform concerns the assignment of the forecasting task to an independent fiscal institution in order to foster technical expertise and to prevent bias.

The problem of disconnect between policy development and policy execution is addressed in a reform that aims to ensure the involvement of executive experts in policy development.

This chapter also presents a reform that aims to clarify the division of tasks between levels of government in order to ensure greater coherence and to reduce unnecessary overlap within each policy area.

Introduction

Policy Development and the challenge of New Public Management

There is an increasing awareness in OECD countries that the New Public Management ethos is likely to create a vacuum in the capacity of governments to undertake policy development. During the course of this study, officials repeatedly discussed this theme whether referring to frustrations over the lack of strategic policy direction, the systemic neglect and undervaluing of technical policy skills over political nous, or general disquiet over poorly designed programmes or policies. Similar challenges have been highlighted in reports by participating governments¹.

These frustrations are not surprising given that public administration reform over the past three decades has given primary attention to building managerial capacities within government. In the 1980s and 1990s, governments sought to "let managers manage" by reducing constraints over resource allocation within departments under the set of reforms that reduced controls in the budget, moved vote structures from input to output, and established accrual based management and budgeting systems, for example. In many countries the public sector industrial relations framework was also reformed away from centralised employment structures to one that delegated authority over employment conditions to individual managers within each department.

Gradually, a second tranche of reforms emerged from the mid-1990s that focused on "making managers manage" by strengthening accountability and supervisory structures. Here the move toward increasingly stringent performance measurement and management regimes emerged as a means of articulating and then controlling the activities undertaken and outputs delivered within departments or agencies. Similarly, the Public Service Acts governing the responsibilities of senior public servants were rewritten to emphasise managers' primary responsibility for ensuring the efficient and effective management within their departments. And the capacity to fulfil this managerial mandate rather than set strategic policy directions became the key criteria for professional success and promotion at the most senior levels of government.

Policy development received little attention under this framework because it is seen largely to be the responsibility of elected officials. So, for example, the adaptation of principal-agent theories to define public sector reform defines the elected government as the "principal" who set out a range of outputs to be delivered by the public sector as the "agent". When coupled with the purchaser-provider models of service delivery, this removes any impetus – or legitimacy – for senior managers to become overly involved in policy development or design. Gradually this had led to a devaluation of the technical skills required for policy development such as research, analysis and evaluation.

The resultant vacuum was filled by building the evaluation work typically associated with policy development within the executive agencies. However, this work typically focuses on improving the current programme delivery mechanisms rather than evaluating the entire programme structure and the choice of policy instruments. Strategic policy analysis is less likely to occur. Questions of policy appropriateness are rarely asked as they may challenge the very rationale of existing agencies. Policy development is driven by the interests of the policy deliverers rather than the recipients or society more generally. Over time this tendency reinforced the *status quo* of policy design. These difficulties were compounded in some countries as reformers defined policy development as a contestable product that could be purchased from external providers. In many

countries this led to a proliferation of policy development entities and forums, while undermining the policy development skills of officials within the core ministries.

Overview of reforms

This chapter draws on cross-country experience in the Value for Money study to suggest seven reforms intended to strengthen the institutions for policy development across government, and thereby improve the quality of policy and programme design. All of these reforms start from the position that line ministries have primary responsibility for policy development within their subject area. So, for example, the Ministry of Education is responsible for working with the Education Minister to actively set a strategic direction for education policy, decide which elements of current policy require evaluation and reform, conduct or co-ordinate the analysis and research to develop policy reform options, and then negotiate those reforms with the stakeholders as necessary. This is a marked shift away from the current approach of many governments in which line ministries continue to take a "hands-off" approach to developing policy and, focus more on managing executive agencies via quasi-contracts and extensive performance measurement and management.

First, policy development capacity within the core ministries needs to be strengthened. Second, expertise from executive agencies should be better integrated into the policy development, without undermining the authority of core ministries. Third, core ministries need to build access to relevant, appropriate and timely policy-based research. Fourth, the creation of independent forecasting institutions will provide all policy makers with better information on economic and fiscal contexts and on the cost of government policy. The fifth and sixth reforms focus on ensuring the rigour and validity of policy development within government by establishing government wide standards for policy evaluation and *ex ante* analysis of the impact of policy change. These reforms are intended to improve the quality of technical analysis being undertaken as an input into policy development. Finally, several governments are reviewing the division of policy responsibilities across different levels of government to reduce the degree of overlap or conflict and to better align with principles of subsidiarity. Typically the division of policy responsibilities in a nation is the outcome of historical evolution rather than deliberate institutional design. Reducing overlap and conflict will achieve savings by reducing administrative efforts and enhancing policy efficiency and effectiveness.

Many of these reforms will require a concerted and sustained co-operation between governments and are likely to invoke claims of constitutional or political impracticality. Yet, throughout this study examples of government striking out boldly to reform and improve policy capacities have been observed. This type of systemic reform is crucial if governments across the OECD are to resolve their budget crises by building the policy development capacity for future generations, rather than deferring the problem through decremental cuts and policy deferral. Together these reforms aim to reinvigorate policy development capacity within government and thereby improve both the cost and the quality of government intervention in society.

Reform 3.1. Strengthening policy development capacity within line ministries

Characteristics of the reform

The reform consists of strengthening policy capacity within line ministries by:

- clarifying the mandate and role of line ministries in policy development *vis a vis* central ministries and executive agencies;
- developing policy skills within the line ministries by introducing a comprehensive professional development programme for policy development staff that is designed to strengthening four key competencies: professional expertise, technical and analytic skills, executive (or delivery) experience and political skills. Reforms should address recruitment and promotion criteria, staff training and development, and on-going job rotation and professional exchange.

Where did it occur?

Australia and the Netherlands are increasingly aware of the need to strengthen policy development capacity in line ministries and over the last few years have taken measures to that purpose.

Analysis

Aims of the reform

Strategic policy development is a core responsibility of line ministries. Policy development should certainly draw on advice from relevant experts and stakeholders within and outside government. However, it is crucial that every directorate in line ministries employs staff with the skills and specialist knowledge to ensure they do not become overly reliant on (and therefore captured by) external advisors and can assess external advice against the broader strategic policy aims of government. Put simply, reforms that strengthen policy development capacity within the core ministries will improve both the quality and cost effectiveness of government policies by ensuring they are subject to rigorous and expert policy analysis.

Interlocutors from countries participating in the Value for Money study repeatedly observed a need to strengthen policy development skills within the line ministries. The concerns expressed by interviewees included high levels of staff turnover which led to a loss of corporate memory; an imbalance between generalist and specialist policy analysts in favour of the former as they are easier to transfer between sectors; a lack of expertise in conducting applied policy research which can be translated into specific recommendations for policy reform. Other concerns included a lack of experience in policy implementation or service delivery which resulted in policies being developed with little recognition of the potential problems during execution, or the impact that policy reform in one area will have for service delivery in related policy or service areas.

Based on the experiences of OECD countries, observed reforms fall into two areas: *i)* clarify the policy development role of core ministries and *ii)* recruitment and staff career development strategies within the line ministries should focus on ensuring relevant staff possess the policy expertise, analytic skills and the political and executive experience required to undertake policy development at the highest levels.

Clarify the mandate and role of line ministries in policy development

Reforms to strengthen the policy development role of line ministries should begin by clearly articulating the policy mandate of line ministries *vis a vis* executive agencies and in relation to other central government ministries. Fundamentally, line ministries should co-ordinate policy development in their own domain. This includes agreeing on an agenda for policy development within the ministry with key stakeholders including the minister, executive agencies and central agencies; monitoring and evaluating the performance of existing programmes within the ministry; and undertaking independent policy analysis with a view to developing options for policy improvement or reform, and focusing on the questions of continued appropriateness and priority.

This study identified numerous instances where line ministries were relegated to a secondary or junior role in policy development. In some countries line ministries must compete with central ministries (such as the Ministry of Finance or the Office of the Prime Minister), political advisors, or external advisory boards for policy influence within their area of responsibility. Elsewhere large, powerful executive agencies control policy implementation, evaluation and research, and can therefore limit access to policy information within the ministry and block the implementation of potential reforms. Both situations mean that line ministries expend too much effort responding or reacting to external demands or pressures, and too little time developing a strategic agenda for policy development, undertaking in-depth policy evaluation, analysis and research, or developing and co-ordinating key policy reforms.

It is crucial, therefore, that governments articulate the primary role of line ministries in policy development and they ensure line ministries have the resources necessary to deliver this mandate. To this end, line ministries need to build their access to relevant, appropriate and timely policy-based research (discussed in Reform 6 of this Chapter), governments should clarify the formal procedures and institutions for cross government policy co-ordination, and efforts should be made to differentiate the policy mandate of the core ministry and of the executive agencies (as discussed in Reform 2 of this Chapter). Most importantly, each line ministry must have a highly skilled cadre of policy officers with the skills and expertise to undertake strategic and autonomous policy development.

Develop policy skills within the line ministry

Efforts to strengthen the policy skills of officials within line ministries should focus on four key competencies. First, and most fundamentally, officials require expertise within their specific policy area. Policy or ‘scientific’ expertise differs between policy areas: in the fields of financial and economic policy, for example, economic expertise is typically required, and foreign policy requires knowledge of foreign countries and the history of diplomacy. Similarly policy expertise in health or education policy draws from specific scientific backgrounds, although expertise is often contested across professional boundaries. In these policy areas managers should consider whether the ministry holds the appropriate balance between areas of professional expertise. In contrast, some line ministries require generic expertise in social or industrial policy: labour market policies, policies for the aged or people with disabilities, business and industry development or market regulation. These ministries should emphasise a balance between economic, social and other disciplinary perspectives.

Second, policy development requires the technical skills to enable the line ministry to undertake rigorous policy analysis and development and remain independent of external advisors. This includes ensuring technical skills related to policy research and analysis,

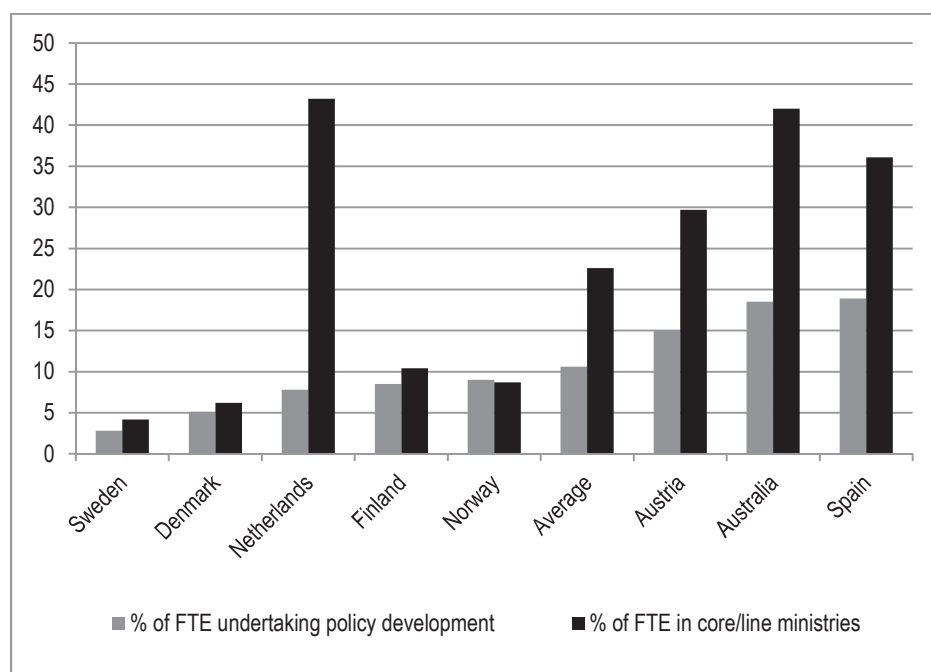
writing new legislation, articulating a strategic direction for policy evolution, and evaluating the effectiveness and efficiency of existing policies within the ministry's area of responsibility. These requirements are not diminished if use is made of external research institutes and consultancy firms. On the contrary, providing guidance to external institutes or firms belongs to the most demanding tasks of policy development staff and this task should generally be assigned to the most senior staff with a proven record of policy analysis in their own right.

Thirdly, those responsible for policy development must also be aware of the practical feasibility of implementing policy options. The complaint that too many policies are poorly designed and generate unexpected problems or simply cannot be executed at all was heard in all countries visited for the Value for Money Study. Experience from many countries suggests that the best way for policy development staff to acquire this awareness is through experience in the execution or implementation of policies (administrative execution or in-kind service delivery). More broadly, executive agencies should be involved in policy development to ensure any potential difficulty in execution is raised and discussed as a routine component of policy development (see Reform 3.2).

Finally, skilled policy development also requires awareness of the potential support for policy reform among politicians and key stake holders. A fully professional civil service can only function appropriately if policy development staff has the confidence of the government of the day, and civil service must engage in constructive dialogue with its political superiors about the merits of policies and to provide “frank and fearless” advice on different options. Indeed this requirement is a necessary condition for the maintenance of a fully professional civil service and for strong restrictions on the use of political advisers. Chapter 10 contains a reform that is specifically aimed at reduction of the use of political advisers.

The implementation of the reform

The viability of clarifying the policy development mandate of line ministries will be shaped by the existing organisational structures and the administrative philosophy of each country. The evidence of this study shows the Nordic countries to have fewer policy development staff than other countries in the study, and much smaller core ministries relative to the executive agencies (see Table 2.4 of Chapter 2). These countries also have strong traditions of separating policy development from policy execution in line ministries and executive agencies respectively. These examples show that policy development can be undertaken with relatively small numbers of civil servants if they have a clear mandate and are well-resourced. Hence, countries should resist the impetus to increase the number of policy development officials as a way of strengthening this function.

Figure 3.1. Small cadre of policy development officials

Source: Snapshots of the public administration.

It is also evident that the separation of policy development from execution makes it easier for the Nordic countries to identify the staff responsible for policy development. During the study it was observed that many countries found it difficult -- and contentious -- to identify policy development staff. There were numerous reasons for this difficulty, including the fact that many staff were performing dual functions (developing and implementing policy), or because there was no clear definition of the "policy development" role. However, this confusion complicates the task of strengthening the skills of policy development staff. It is important that countries take measures to improve understanding of the tasks and roles that constitute policy development, and the staff that are involved in these tasks. This will be an important precursor to reforms intended to strengthen policy development skills and hence the quality of policy development outcomes.

Effort to clarify and strengthen the policy mandate of line ministries may be resisted in countries with administrative philosophies that encourage numerous actors to engage in policy development. Australia and the United Kingdom, for example, encourage "a challenge and scrutiny role" of the central agencies. Others have argued that this increases the market in policy ideas, but does not facilitate policy development. Sweden and the Netherlands ensure that external experts, stakeholders and advisors are incorporated into the process of policy development while maintaining the primacy of the line ministry in the process.

In countries where the line agencies have a clear policy mandate, reforms focus on strengthening the skills of policy development staff in line ministries. Countries should consider adopting a whole of government approach to developing the standards for the recruitment of policy development staff, and on establishing a whole of career development programme for policy officers. Wherever possible, responsibility for developing and managing these programmes should lie with the agency responsible for

public sector employment such as the Australian Public Service Commission, or the Department of Public Administration in Sweden.

A number of governments have taken steps to articulate the core competencies required in policy development and these should be further developed to articulate the basic competencies required when recruiting policy officers. Potential staff should evidence both experience and aptitude in the technical skills required to undertake policy analysis and research, and the specialist knowledge appropriate to a given policy areas. It is also important to ensure that technical skills are continually extended and honed via professional development programmes, and delivered in partnership between government, universities, or other expert providers. To reinforce the professionalization of policy development work, ministries should require proven experience in research and/or execution in the same policy area as a pre-requisite for promotion to higher job levels in policy development.

Developing high level political and executive skills requires experience rather than training, and therefore should be built through programmes for career development. These should provide job rotation opportunities within a particular policy area, including between jobs in the same ministry or in a few kindred ministries (finance and economics, foreign policy and defence), rather than across the entirety of central government. These programmes should also facilitate job shifts between research institutes, executive organisations (administrative execution and/or service delivery) and policy development in the same policy area. The flexibility of civil service employment conditions will limit the extent to which these are possible, and it may be necessary to establish a government wide policy standard that facilitates job rotations rather than relying on individual organisations (see Chapter 8).

Feasibility of the reform

The reform is relevant for all OECD countries, but the challenges resulting from existing organisational structures and constitutional arrangements are different between countries. This implies that the focus of the reform has to be tailored to the circumstances of the country and that implementation procedures have to ensure that bottleneck factors are addressed with priority.

Reform 3.2. Integration of executive and professional expertise into policy development

Characteristics of the reform

The reform consists of integrating executive and professional expertise into policy development. Executive agencies should commit to policy proposals before they are tabled for political decision-making in Cabinet or Parliament and this can be achieved by giving a role to executive agencies in the initiation and elaboration of policy proposals, and having executive agencies represented in the ministerial staff group by which all policy proposals are selected, developed and approved.

Where did it occur?

Sweden has a centuries old tradition of separating policy development in line ministries from policy execution in arm's length agencies, and it has relatively small line ministries. As a result, policy development units within the line ministries rely heavily on

executive agencies for information and advice, and the mechanisms for integrating executive agencies into policy development are clearly established.

In Sweden, the involvement of executive agencies in the policy development takes two forms. First, agency officials are consulted about the main aims and features of the proposed reforms from an early stage of the process of policy development. Executive agencies can also initiate reforms themselves, and bring their ideas to the attention of the minister and the staff of the core ministry. Second, agencies are invited to contribute to reform proposals by providing information and analysis and usually by providing detailed elaboration on the practicalities of executing or delivering the policy proposals.

Analysis

Aims of the reform

The importance of involving executive agencies into policy development is generally recognised by all countries participating in the Value for Money Study. Executive agencies within government should always be asked for advice on proposals for policy reform, be allowed to initiate their own reform proposals, and asked to elaborate certain reforms in collaboration with policy development staff in line ministries. The advice of executive agencies should be taken seriously as they understand the key issues needed to ensure successful implementation of policy or service delivery reforms. Integrating executive and professional expertise into policy development has the primary objective of improving the quality of proposals for policy reform. Throughout this study, interlocutors mentioned policy reforms that could not be implemented due to poor programme design or that had a negative impact on existing programmes.

The reforms discussed in this section aim to balance the need to integrate executive agencies into policy development, while retaining the authority of line ministries to set the strategic direction of policy within the ministry. The key reforms revolve around the extent to which executive agencies are integrated into policy development, and how this involvement should be organised. In this respect the experience of Sweden provides some good examples and lessons that can then be adapted by other countries.

Since policy execution is not only taking place in agencies, but also in non-profit organisations inside and outside central government, it is important to look also at the involvement of these organisation in policy development. This regards mainly in-kind service delivery (not administration). In the fields of education, health, social services and culture, there exist councils of boards of non-profit institutions that meet regularly with the minister and advise on policy development. In general this mechanism is useful, but non-profit institutions have a different role than public executive agencies, even if they are supposed to be controlled by, and mostly financed by, government (and thus classified inside the government sector). The non-profit institutions are not only executive institutions of government policy, but also service providers in competitive markets (see Reform 4 in Chapter 4). In view of their latter role they should not be given a formal role in policy development.

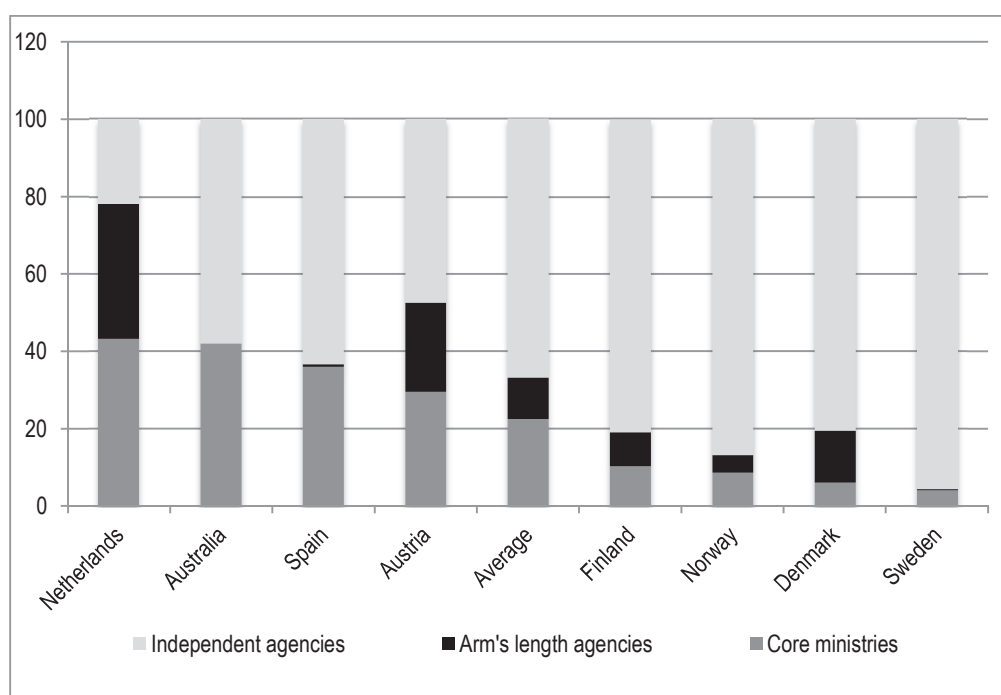
Implementation of the reform

The feasibility of these reforms depends on the extent to which policy development and execution are currently differentiated. If the two functions are clearly separated, then the challenge is primarily one of integration. If however, policy development and execution are largely indistinguishable activities then there is an additional challenge of

differentiating between units responsible for these functions before ensuring co-operation on policy development. This is not simply a question of organisational form. While it is desirable for policy officials to have expertise in policy execution - and vice versa -- the two functions require different expertise and specialist skills. As a general principle, they should not be undertaken by the same person or unit because the day to day practicalities of delivery tend to dominate over questions of policy development.

So, before considering these reforms, it is important that countries understand where policy execution is currently located. At a general level, this differs significantly between countries in the Value for Money study. Overall, the Nordic countries have a much higher percentage of public officials employed executive agencies than other countries. This is represented by the figures in Figure 3.2 below. The figures are illustrative of a long standing tradition of institutionally separating policy development from execution.

Figure 3.2. Size of core ministries and executive agencies



Source: Snapshots of the public administration.

Most other countries participating in this study organise policy development and execution according to much less systematic or rigorous criteria – most are the product of history. Supposing policy execution is organised in arm's length agencies, involvement of the agencies in policy development could mainly be arranged along the Swedish lines as discussed above. First, agencies would have to be involved in all policy initiatives from the start. In order to make sure that this will happen, it is useful that all agency directors are given a seat in the management board of the ministry (in so far as this is not already the case). Agencies should also be encouraged to table reform proposals on their own initiative. Second, it should become common practice that agencies are invited to provide concrete support in policy development. This includes not only information and analysis but also elaboration of proposals and legislation. Obviously, the process of policy making has to be co-ordinated by the core ministry, but agencies could contribute a great deal

more than is currently the case. There is every reason to assume that this would contribute considerably to the quality of policy development.

Feasibility of the reform

The reform is relevant for all countries participating in the study. The implementation has to take into account the current organisation of policy execution and requires tailored solutions in view of the organisational structure of policy execution in every country and every policy area.

Reform 3.3. Transfer of policy research institutions to universities, private research establishment and consultancy firms

Characteristics of the reform

The reform consists of transferring government policy research institutions to the universities and private research sector with the aim to strengthening policy makers access to timely, relevant, independent and rigorous policy focused research. This reform is intended to increase the research budget available to policy development staff in core ministries, but it can also lead to savings.

Where did it occur?

Denmark transferred most policy research to universities in 2006 as part of a comprehensive reform of the university sector.

Analysis

How to organise policy research in support of policy development

This reform aims to ensure that officials in core ministries have access to rigorous, relevant and timely policy research to inform policy development. Since the Blair government argued that “what matters is what works”, governments have renewed their efforts to build an "evidence-based" approach to policy development. This requires that policy development officials in all divisions of the core ministries can mobilise independent information about the effectiveness of policy options, and engage with external expertise and networks of research institutes. However, this expertise should be supported by access to external experts with an on-going mandate to undertake primary and applied policy research. Some countries have sought to build policy research capacity inside government by establishing in-house policy research institutions. Elsewhere the emphasis has been on shaping the research agenda of individual researchers by providing research grants.

There are problems with both of these approaches. First the in-house research institutions struggle to find a balance between policy relevance and academic independence, and the researchers interviewed for this study typically placed greater emphasis on the latter. Often this has led to a lack of policy relevance and a combative relationship with policy development officials. Second, engaging individual researchers is also problematic as it ignores the practical realities of academic life where "publish or perish" has become a daily mantra. Engaging primarily with individual researchers also fails to build an institutional capacity for policy research and analysis that can be leveraged by governments over the longer term.

The experience of Denmark in moving most policy research institutions from government to the university sector suggests that the core ministries can access independent *and* relevant policy research without requiring this be undertaken inside government. In 2006 the government of Denmark implemented reforms that integrated all but four government research institutions into the university sector. The reforms occurred within a broader context of restructuring the governance and funding arrangements with universities and a commitment to increase government spending on research and development to 3% of GDP in accordance with the Barcelona Agreement.

Specifically, the reforms occurred at three levels. First, the ministry of Science, Technology and Innovation undertook a review of all government research institutions to identify those working in closely related policy areas, and then took steps to merge these institutions. Next, nine of thirteen government research institutions were transferred to universities with recognised expertise in the policy area. Importantly, the universities were willing participants in the process as they gained highly qualified research and teaching staff, additional public funding, and the influence that comes from better contact with government policy makers. Thirdly, the funding relationship between policy research institutions and the core ministries was made more explicit by differentiating between two levels of funding: base funding and commissioned research. Government provide most institutions with a base budget to fund a percentage of on-going staff to conduct basic research and long term projects such as maintaining databases that track the impact of policies in a specific area of government. Additional funding is then agreed between the line ministry and the institutions for evaluations commissioned by government – these may be funded through competitive tender for specific evaluations, or to a contractual agreement to conduct a given number of specific evaluations over a discrete time period (for example three evaluations a year for three years).

Conditions for successful implementation

Officials in the Danish government argue the reforms were successfully implemented for a range of reasons. First, the questions of *enhancing* research capacity across Denmark "rose to the top of the political agenda" and therefore both political and administrative resources were dedicated to the reform task. There was a public expectation that change would occur and this provided the political mandate for comprehensive reform. As a result, the merger process occurred quickly and within 6 months of the Cabinet decision to transfer public research institutions, and this reduced both uncertainty and the opportunities for blocking strategies.

Second, specific elements of the reform agenda were developed in consultation with the key stakeholders in the university and government sectors, to ensure they were widely accepted and easily implemented. A number of interviewees emphasised the importance of tailoring the reform programme to each university in recognition of the unique circumstances of size, expertise, geographical location, and the balance between the existing research staff and those from the public research institutions. Not surprisingly some researchers from the public research institutions resisted relocation for personal reasons.

New procedures should also establish mechanisms for disseminating research findings and ensuring collaboration between researchers and policy professionals. The relationships between those undertaking policy development and policy researchers will not be enhanced by this reform unless deliberate efforts are made to improve the co-ordination and dissemination. Physical distance from policy makers was also identified as

a logistical problem in ensuring the ongoing networks between policy makers and researchers, and in some instances it had led to difficulties in recruiting or retaining suitability qualified personnel. ICT technology can play an important part in solving these problems. Clearly the size and geographical distributions within countries will shape the importance of this issue.

In 2009, an International Evaluation Panel assessed the impact of the university mergers. While this evaluation focused primarily on mergers between the universities themselves as well as between universities and formerly independent research institutes, there are useful lessons in relation to the impact on policy development in core ministries. As stated in official papers, these reforms were designed to increase:

- efficiency by abolishing closed shop and automatic funding arrangements that existed within the public sector research bodies, and
- effectiveness by "creating critical mass and research synergies" that improve the quality of research.

Concern was expressed that these reforms would weaken the support that research institutes provide to strategic policy makers in core ministries. Interviewees raised some problems in relation to the knowledge transfer activities between universities and policy officials. Another ministry was frustrated by a limited capacity to leverage knowledge held and developed within these institutions for the purposes of policy development. Some ministries indicated that they have difficulty in shaping the research agenda and getting timely, relevant and applicable advice.

As it turns out, however, the same complaints concerning the lack of support for the government research agenda were voiced about "in-house" research bodies as about the universities, and similar concerns were expressed by interviewees from the line ministries in Sweden about the fact that autonomous evaluation agencies pursued an independent research agenda regardless of the government agenda.

It appears therefore that the legal status of research institutions is less important for the support of policy development than the contracts which define their co-operation with the government. In this light, governments may reconsider the contractual relations between line ministries and research institutions. Attention should be paid to the relevance of research findings for policy change or development. A distinction could be made between long term contracts involving the development and maintenance of databases and periodical surveys and short-term contracts aimed at the preparation of one off reforms, while maintaining competitive and objective tendering procedures. Special attention should be paid to requirements securing the confidentiality of data. If such requirements are applicable they should be included in the contracts so that no controversy can arise once the research is under way.

Feasibility of the reform

The levels of investment in public research institutions vary across OECD countries. In countries with a large number of public research institutions, benefits are likely to result from a systematic review of the sector, with a view to merging related institutions to create a critical mass of researchers, and reduce administrative costs.

Very large public research institutions may not be suitable for amalgamation within existing university arrangements. In the Danish experience four public research institutions were not transferred for various reasons. The Danish National Centre for

Social Research for example had approximately 65 researchers with expertise in social policy research and was therefore the largest evaluation centre in the country. The centre focuses on evaluating social policies across government, as requested (and funded) by line ministries. This centre retains “academic” status by undertaking basic research, training PhD students and retaining the right to publish. However, its primary function is to ensure the quality of policy evaluation by developing guidelines, undertaking evaluations, and providing advice on policy and programme design to ensure evaluations are possible. Hence this institution is primarily a provider of shared evaluation services rather than purely a public research institute.

Reform 3.4. Independent fiscal forecasting institutions

Characteristics of the reform

The reform consists of the establishment of an independent fiscal institution (IFI) for macro-economic forecasting and costing of major policy proposals. A major goal of the IFI is promotion of fiscal transparency. Careful attention should be given to ensuring the IFI works for the executive and legislative arms of government, as well as for civil society organisations (possibly at a cost). The IFI should avoid duplication of forecasting and costing efforts within the central government as a whole.

Where did it occur?

Among the countries participating in the study, IFIs have been established in Australia, Canada, Finland, France, the Netherlands, Sweden and the UK.

Analysis

Tasks performed by IFI's

Independent fiscal institutions are a growing phenomenon in OECD member countries, aimed at improving the information base from which policy development and analysis proceeds, and from which citizens are informed. Particularly in the wake of the financial crisis, governments, regional and international bodies are looking to IFIs as a way to enhance fiscal discipline and promote greater transparency and accountability.

Until the turn of the century, IFIs existed only in Belgium, the Netherlands, Sweden and the United States. Among OECD countries, many of the features of these IFIs were adapted in Korea and Canada. Following the recent financial crisis, IFIs proliferated quickly not only across the European Union (Hungary, Slovenia, UK in the last decade alone), but also in Australia and Chile. Most recent IFIs can be found in Finland, France, Germany, Italy, and Spain. By now IFIs operate in more than 20 member countries—the precise number depending on the breadth of the definition of what constitutes an IFI.

Beginning in 2012, the OECD established a reference group of heads of IFIs of selected member countries to examine the experience of existing IFIs and develop draft principles of good practice. Specifically, the OECD Principles for Independent Fiscal Institutions make recommendations in nine domains: 1) local ownership, 2) independence and non-partisanship, 3) clearly legislated mandate, 4) resources, 5) relationship with the legislature 6) access to information, 7) transparency, 8) communication, and 9) external evaluation. This section draws on the Principles as well research conducted for the Value for Money study; however, readers should consult the Principles endorsed by OECD Council for more detail (OECD, 2014).

Notwithstanding widespread differences, the aims and tasks assigned to IFIs can be divided in two main domains: First IFIs can have an *ex ante* diagnostic role in preparing independent short- and medium-term macro-fiscal forecasts, policy costing, and/or policy analysis.² Secondly, IFIs can fulfil an oversight role with respect to fiscal policy proposals and outcomes against rules or objectives. IFIs do not replace the treasury or ministry of finance in formulating fiscal policy, nor do they replace the *ex post* accountability function of the national audit office. In terms of policy development, the primary aim of establishing an IFI is to provide policymakers, as well as the citizenry, with access to independent and rigorous analysis of fiscal policy and performance and on the budgetary cost of government policy initiatives.

The form and structure of IFIs vary considerably across countries. While some are headed by an individual, others operate under collective leadership; some are endowed with a large technical staff, others are not.

By way of illustration, table 1 compares the tasks assigned to independent fiscal institutions in five countries participating in the Value for Money study as well as the US (the Congressional Budget Office being an inspiring example for many other countries).

Table 3.1. Tasks of forecasting and costing institutions in selected OECD countries

	Netherlands Central Planning Bureau (CPB) (1945)	US Congressional Budget Office (CBO) (1975)	Sweden National Institute of Economic Research (1937)	Canada Parliamentary Budget Office (PBO) (2008)	United Kingdom Office for Budget Responsibility (OBR) (2010)	Australia Parliamentary Budget Office (2011)
Agency of:	Ministry of Economic Affairs	Congress	Ministry of Finance	Parliament	Ministry of the Treasury	Parliament
Short and medium term macro-economic forecasting	Yes, unique	Yes	Yes	Yes	Yes, (in principle) unique	No
Long term macro-economic forecasting	Yes, unique	Yes	Yes	Yes	Yes, unique	No
Costing	Yes, unique	Yes	Yes	Yes, on request	No, only scrutiny	Yes, but not leading to duplication
Costing of electoral platforms	Yes, unique	Yes	No	No	No	Yes, but not leading to duplication
Monitoring of fiscal policy against rules and objectives	No	Yes	No	Yes	Yes	Yes (implicitly)
Policy research on own initiative	Yes	Yes	Yes	Yes	Yes	Yes

The Dutch and UK IFIs stand out in that they are tasked with macroeconomic forecasting for government as well as parliament. In these countries it is felt that this arrangement has two important advantages.

First, it avoids the cost of duplication. Given that the basic reason for establishment of an IFI is that the government numbers may be affected by an optimistic bias, and will inherently always be perceived as politically self-serving, the dominant view in these countries has been that there is no reason to continue producing these numbers as soon as an IFI is established.

Second, the governments concerned feel that it is desirable for the political debate to be conducted on the basis of a unique set of numbers. While it is generally recognised that forecasting and costing are difficult arts and that with retrospect predictions were often wide of the mark, there is nevertheless an advantage in leaving these “technical” problems out of the political debate. In countries where IFIs are the unique providers of forecasts, it is generally felt that agreement among the major political parties that the political debate will be conducted on the basis of the numbers of the IFI, has a beneficial effect on the quality of the debate and of subsequent decision making.

The Dutch and Swedish IFIs stand out in that they do not fulfil an oversight function with respect to fiscal policy proposals and outcomes against rules or objectives (the second task of IFIs mentioned above). It is widely felt in the Netherlands and in Sweden that this assessment task is not compatible with the forecasting and costing tasks assigned to these institutions and would complicate their role as the government’s forecasting and costing institution³.

The Parliamentary Budget Office (PBO) in Australia is unique among IFIs, in several respects. It is not allowed to do forecasting (to avoid overlap with the Department of Treasury) and will do costing only for members of Parliament if these members (possibly of the opposition) have not asked the Government to do the costing of the same proposals. The latter arrangement is meant to avoid duplication, but the OECD Secretariat has noted that it is problematic from another point of view, namely, that different proposals are costed by different institutions (OECD, 2012b). In addition, unlike all other IFIs, the PBO is not authorised to release its assessments to the public. Furthermore the Australian IFI is not required to carry out the monitoring task in relation to fiscal rules or objectives (the watchdog task). Rather it is entitled to do so under the prevailing enabling legislation. As elsewhere, to ensure that the PBO in Australia has access to the information necessary to fulfil the costing tasks, the founding legislation provides broad ranging powers to access information from Commonwealth bodies.

Both the Australian and Dutch IFIs stand out in that they are undertaking costing for electoral platforms. Costing of electoral platforms has the effect of focusing the debates during the electoral campaigns on policies rather than on the facts. A supervisory committee of the IFI can be charged with approving the work programme of the IFI and to see to it that opposition parties are served in the same way as the government and the government parties.

There is no consistency across countries on whether the IFI is established as an agent of the legislative, the executive, or the judicial branch. The Australian PBO is an agency accountable to Parliament with the same status as the National Audit Office and serves both chambers of Parliament. In contrast, both the OBR and the CPB are under the Executive branch of government rather than Parliament. The OBR is a legally independent agency with its own oversight board; the CPB enjoys the status of an

independent agency under the Ministry of Economic Affairs, with its independence guaranteed by statute. Over a broader spectrum of countries, whereas most IFIs are established under the tutelage of the executive or the legislative branches, there are a few (Finland and France) that operate in the Court of Audit as part of the judicial branch, and others (including Hungary, Ireland, and Portugal) that are not attached to any branch. Regardless of the formal statutory arrangement, what really matters is the effective degree of independence of the institution.

Finally, questions of staffing and budget allocations also differ across countries. The Australian, Dutch and UK IFIs may serve as illustrative examples. The IFI's in Australia and the United Kingdom are relatively small institutions. The Australian PBO is financed by an appropriation of AUD 6 million (~EUR 4.75 million) in the financial year starting on 1 July 2011 and it is expected to receive a similar amount for the next three years. It is envisaged that the PBO will employ about 20 economic analysts. In the UK, the OBR is even smaller with an annual budget of GBP 1.75 million (~EUR 2.15 million) and a staff of 15 economists – the majority of whom are ex-treasury officials. By contrast, the CPB in the Netherlands has a staff of 160 (140 full time equivalents) and an annual budget of approximately EUR 12 million. Up to two thirds of staff in the CPB are academic economists and the remainder are statisticians and support staff. Eighty-five to ninety percent of the CPB budget is appropriated, and they earn the remaining 10-15% from project contributions by ministries, the European Union and other international organisations (including the OECD). These differences are illustrative of the broader mandate of the CPB as discussed above.

Feasibility of the reform

The applicability of this reform to Value for Money countries differs according to the current state of practice. In those countries that have not established an independent fiscal institution, steps have to be taken to ensure immediate adoption in accordance with the OECD principles discussed below.

At a very minimum, the mandate of the IFI must be set down in legislation and clearly define the tasks and analysis to be undertaken and the reports be produced. As discussed above, IFIs undertake a range of tasks including macroeconomic and fiscal projections (with a short- to medium-term horizon, or long-term scenarios); costing of major policy proposals and electoral platforms, monitoring compliance with fiscal rules or official targets; and analytical studies on selected issues.

While each country should decide which tasks are most appropriately undertaken by the IFI, the reform as formulated here follows the Dutch and UK model, in that the IFI serves as the unique forecasting and costing institution for government, parliament and civil society and that duplication is avoided. This fits into the approach of the current study that aims at presenting reforms that lead to simplification and savings. Furthermore it follows the Dutch and Swedish model in that reforms aim at the establishment of an independent forecasting and costing institution, regardless of how the role of monitoring against fiscal rules or objectives (the “fiscal watchdog” role) is carried out (in principle allowing that this role is assigned to another independent institution).

It is also important to establish mechanisms to encourage appropriate accountability to the legislature, as well as the public at large, regardless of whether the IFI is created as an agent of the legislature, executive, or the judiciary. These mechanisms may include (but are not limited to): 1) all reports sent to parliament for scrutiny, preferably through the legislature's budget committee (or equivalent) and in time to contribute to relevant

legislative debate; 2) appearance of IFI leadership or senior staff before the budget committee (or equivalent) to provide responses to parliamentary questions; 3) parliamentary scrutiny of the IFI's budget; and 4) a role for parliament (including the budget committee or equivalent) in leadership appointments and dismissals.

Reform 3.5. Whole of government standards for *ex post* evaluation

Characteristics of the reform

The reform consists of establishing whole of government standards for the conduct of policy evaluation in line with practices from Canada and the UK and ensuring that line ministries hold primary responsibility for planning, conducting or commissioning policy evaluation.

Where did it occur?

The UK and Canada have established government wide standards for the conduct of policy evaluation.

Analysis

Government wide standards of evaluation

The impetus for establishing government wide standards in evaluation derives from a quest to strengthen the capacity for relevant evaluation to support policy development within each line ministry. This reform assumes that line ministries are engaged in the work of strategic policy development, including the conduct and/or commissioning of policy evaluation. Core ministries need to ensure they have access to independent and relevant policy research (as discussed in Reform 3.4) although this work does not need to be undertaken inside government.

This reform addresses policy evaluations undertaken to assess and adapt existing policies or programmes. Responsibility for conducting policy evaluation primarily lies with line ministers as they are accountable to parliament and their cabinet colleagues for the effectiveness and efficiency of government policies. This incentive is particularly strong when ministers are newly appointed and want to reform the programmes for which they are responsible. Ministers need support to undertake critical evaluation because their own ministries will not always be supportive of critical evaluation. Civil servants often have a tendency to defend existing programmes. The same is true for long serving ministers.

To this end standards should be set that ensure all evaluations are methodologically rigorous and relevant to the policy concerns of both the ministry and the overarching agenda of the government. This should include articulating the governance framework that assigns primary responsibility for conducting policy evaluation with line ministries rather than executive or autonomous bodies. This will minimise the possibility of capture by those who have vested interest in the *status quo*, or lack a whole of ministry or whole of government perspective. Similarly, evaluation can be strengthened by requiring they follow a standard process and adopt rigorous methodologies. This in turn strengthens confidence that evaluations finding are based on analytically objective and independent research, which allows the line minister and ministry to be critical of existing policies and programmes in the interest of policy improvement.

Standards of evaluation in the UK and Canada

The governments of the United Kingdom and Canada have both introduced government wide standards to enhance the quality and to build incentives for conducting relevant and rigorous policy evaluation. In Canada, the evaluation standards set out governance structures and accountability arrangements that assign line ministries with the responsibility for ensuring all existing departmental programme spending is evaluated every five years. In contrast, the UK Treasury published "The Green Book" which sets down the procedures and methodologies that can be used by all line ministries at various stages in the policy life-cycle. However, in the UK there is no obligation to evaluate. The Green Book only provides guidelines for the case that an evaluation has been ordered on a needs basis. Interested governments should consider using the experiences of both countries when developing whole of government standards for policy evaluation.

The UK Green Book: appraisal and evaluation in Central Government (2003, updated in 2011) explains the processes and methodologies that should be used to assess government policies at various stages in the policy lifecycle, from inception to evaluation. Policy evaluation is treated in Chapter 7 of the Green Book, which states: "Evaluation requires management initiative (sometimes political commitment) and intensive monitoring. The thoroughness of an evaluation should depend upon the scale of the impact of a policy, programme or project, and to some extent on the level of public interest. [...] Evaluation reports should be widely disseminated and published, where appropriate, to contribute to the knowledge base up which future decisions will be taken."

Essentially, the Green Book aims to support "analytically robust appraisal and evaluation" by providing detailed descriptions on six different analytical methodologies in a series of appendices. While only one chapter of The Green Book discusses evaluation specifically, other chapters provide guidelines for policy analysis that can also be included in an evaluation. These include, justifying government activity (Chapter 3); clarifying policy objectives (Chapter 4), and undertaking options analysis (Chapter 5). This publication is disseminated widely throughout the government and sets a benchmark of evaluation best practice that must be adhered to in all official evaluations of government policy.

The experience of Canada provides another useful example because it sets down a standard governance framework for the conduct of programme evaluations. Importantly, it allocates responsibility for evaluation to the line ministry, rather than either the central ministries or executive agencies.

Briefly, in 2009 the Government of Canada introduced a cabinet approved policy on evaluation in government with application to all departments. The stated objectives of this policy are to "create a comprehensive and reliable base of evaluation evidence that is used to support policy and programme improvement, expenditure management, Cabinet decision making, and public reporting" (Government of Canada, 2009: Section 5.1). The policy identifies the (permanent) head of each line ministry as responsible for establishing a "robust, neutral evaluation function in their department". To this end, each department must create a Departmental Evaluation Committee of senior officials which is chaired by the "deputy head or senior level designate". The deputy head must ensure that the evaluation committee has "full access to information and documentation needed or requested to fulfil their responsibilities... and that sufficient performance information is available to effectively support the evaluation of programmes."

Feasibility of the reform

The recommendation to develop and publish a set of government wide evaluation standards is relatively straight forward and has generic applicability. Methodologically, the standards set down in the UK Green Book adhere to the fundamentals of good qualitative and quantitative analysis, and the publication explains the linkages between the objectives of an evaluation and the choice of approach or methodology. It can therefore serve as a useful starting point from which countries can develop a similar publication. Countries may also find it useful to develop a suite of on-line tutorials or similar educational tools as a secondary resource which provides detailed instruction in the application of each methodology. Responsibility for developing these guidelines could be assigned to experts in the Ministry of Finance, to a special purpose expert working group, or to educators with recognised expertise in the field of policy evaluation. The publication should be disseminated throughout the core ministries and on-line.

The challenge in implementing this reform is to ensure the rigorous application of these standards whenever line ministries undertake policy evaluation. Both the UK and Canada have budgetary rules requiring all proposals for policy expansion be supported by evaluations that adhere to these standards, and Canada requires all evaluations be submitted to Cabinet and made publically available. More importantly, all line ministries in Canada must now appoint a Head of Evaluation to oversee and guarantee the quality of evaluations conducted within the ministry. In doing so, evaluation is recognised as a discrete activity in policy development that requires professional skills and adequate funding.

Finally, evaluation standards should discuss the importance of linking evaluation findings and the policy development work conducted in the line ministries. Throughout this study interviewees from both ministries and those responsible for conducting evaluation expressed their frustration about the limited use of policy evaluations in policy development. Policy officials from the ministries repeatedly highlighted their difficulties in shaping the programme of policy evaluation or in getting access to evaluation findings that were timely, relevant and applicable. Conversely, many evaluators raised the need to balance the need for independence when conducting evaluations with the demand to ensure that evaluation topics and findings were relevant to policy makers. The Canadian experience suggests that line ministries should establish a whole of ministry evaluation committee that is chaired by the most senior civil servant in the line ministry and including the heads of policy development and key executive agencies.

Canada's experience also suggests that countries should be wary of establishing an overly prescriptive forward agenda or cycle of evaluation. The policy in Canada states that line ministries should ensure that all major programmes are evaluated over a 5-year cycle. In practice, this has often led to "compliance" evaluations or to blocking strategies by officials responsible for policies and executive programme managers. A similar experience occurred in Australia under the Portfolio Evaluation Programme in the early 1990s. To overcome these problems, it is important to ensure that the policies to be evaluated are selected on a "needs" basis. There should also be significant input on the selection of programmes or topics from the line minister.

Reform 3.6. Whole of government standards for Regulatory Impact Analysis and for Cost-Benefit Analysis

Characteristics of the reform

This reform consists of establishing whole of government standards for the conduct of regulatory impact analysis (RIA) and cost benefit analysis (CBA) to strengthen policy development capacity. These standards should establish both technical competencies and procedural requirements for undertaking RIA and CBA in relation to the development of proposals for new regulatory and infrastructure policies.⁴

Primary responsibility for planning, conducting or commissioning both RIA and CBA should lie with line ministries as the key actors in policy development. These analytical techniques should be recognised as a core skill of policy development and therefore technical training should be provided as part of the professional development for policy officers within line ministries.

A specialist unit located in the ministry responsible for the business sector (usually the Ministry of Economic Affairs) should provide expert technical advice, procedural oversight and government-wide co-ordination. Experience of countries participating in this study suggests this unit should be a professional centre of analytical excellence within government.

Where did it occur?

This reform focuses on ensuring the government operates with a common set of professional standards and those standards are applied in practice as part of the policy development procedures within line ministries and across government. All countries participating in this study report centrally mandated requirements for undertaking CBA and RIA as part of new policy development, and most standards are informed by the best practice principles set down by the OECD.

This reform draws on the recent experience of Australia in reforming their processes for Regulatory Impact Analysis and Cost Benefit Analysis as an example of how to ensure analytical techniques are applied during policy development and on how the whole of government oversight and technical support can be organised.

Analysis

The need for adopting government wide standards for RIA and CBA in policy development

The essence of this reform is that governments should adopt appropriate specific techniques when analysing the social costs and benefits of policies that have major impacts on the private sector of the economy. The need to adopt sophisticated analytical tools holds in relation to the development of new policies and programmes, and when evaluating the continued appropriateness of existing programmes.

It is standard practice in all OECD countries that new policy initiatives that have fiscal impacts, either on the expenditure or the revenue side of the budget, can only be tabled for government decision-making, if the proposals are accompanied by a fiscal impact table. This applies to policy initiatives that are implemented by regulations, including regulations concerning financial instruments such as grants, subsidies and

social benefits, as well as to initiatives that do not require regulations, such as infrastructure projects. Moreover, in countries using an expenditure framework (see Reform 3.7), new initiatives can only be tabled if the line ministry has reached agreement with the Ministry of Finance that the fiscal impacts can be accommodated within existing expenditure ceilings, either because the ceilings were established in a way that anticipated the new policy initiative, or because the line ministry has made room for the initiative under its ceiling by offering compensation.

However, these practices do not cover impacts on the private sector of the economy. Obviously these impacts have to be assessed *ex ante* in the documentation of the new policy initiative, but for initiatives with major impacts, this is perceived as not enough. For this reason many OECD countries have developed special *ex ante* assessment tools that aim to provide objective information on impacts on the private sector, in particular Regulatory Impact Analysis (RIA) and Cost-Benefit Analysis (CBA).

There is a vast literature on both the technical and practical challenges of these tools. This literature is not repeated here but it is useful to mention three key explanations why instruments with major impacts on the private sector require particular attention in *ex ante* assessment.

First, the costs of programmes with impacts on the private sector are difficult to fully capture using traditional models of policy analysis. Put simply, the costs of regulatory policies are defrayed between governments, individuals, organisations or communities required to comply with the regulation. The latter costs include the administrative costs of regulatory compliance, and the costs of economic or behavioural restrictions imposed in the regulations. Measuring the full cost of infrastructure programmes is similarly complicated by the need to capture expenses which run over many years through multiple project stages, including planning, financing, construction, operation and maintenance.

Second, capturing and measuring the full benefits of regulatory and infrastructure programmes are also complicated by the fact they are typically used to produce collective goods diffused across society, or only achieved over a relatively long timeframe. In the aftermath of the Global Financial Crisis for example, governments are placing a renewed emphasis on the value of government regulation as “one of the key levers by which governments act to promote economic prosperity, enhance welfare and pursue the public interest” (OECD, 2012c).

Third, together these analytic challenges complicate the process of analysing the full impact of regulatory and infrastructure policy instruments both independently, and in comparison to other instruments. This has resulted in concerns about a bias in favour of regulatory instruments and an oversupply of government infrastructure. For example, international history in relation to regulatory development shows a rapid increase in regulatory costs being sustained over several decades. The OECD found in 2002 that every available indicator and study show that regulation continues to be one of the most widely used tools of government, and that its use is rapidly increasing (OECD, 2002:22). Concerns about the cumulative impact of government regulation on society and the economy have seen some government adopt policies designed to limit regulatory costs, whether in specific areas or as a global total. Some countries have developed “regulatory budgeting” provisions which set a specific target in relation to total regulatory costs; others have adopted a “one in, one out” approach.

This reform addresses concerns over the quality and quantity of regulatory and infrastructure policies by ensuring that governments are able to apply the most rigorous

analytic and procedural standards whether developing new policies or evaluating existing ones with major impacts on the private sector. In this regard the 2012 recommendations of the OECD Council on Regulatory Policy and Governance sets the standard:

“...an explicit whole-of-government policy for regulatory quality. The policy should have clear objectives and frameworks for implementation to ensure that, if regulation is used, the economic, social and environmental benefits justify the costs, the distributional effects are considered and the net benefits are maximised”. (OECD, 2012c:2).

At a minimum this will require governments to (a) establish whole of government standards for the conduct of RIA and CBA to be applied rigorously and appropriately during the development of new policy proposals; (b) create a specialist unit with responsibility for building and maintaining the technical skills of policy development officials in line ministries, and co-ordination and oversight of RIA and CBA across government. The feasibility and prerequisites of each recommendation are addressed below.

Establish government wide standards for RIA and CBA in new policy development

All countries participating in the Value for Money study reported some requirements for conducting RIA or CBA as part of the new policy development. There was, however, wide variation in terms of the technical and procedural requirements embedded in these standards, the rigor and breadth of application, and the extent to which common standards have been established across government. In terms of the latter, many countries state that these analyses *should* occur and left line ministries to decide how and when. This results in duplicated effort, disparity of capacity and application, and an array of slight variations in the techniques adopted across government undermining the technical comparability of new policy proposals. Governments should overcome these problems by developing a simple and easily accessible handbook explaining how and when CBA and RAI should be used during the policy development process, and establishing this as a prerequisite for the submission of a proposal for government approval.

The first component of the reform is to develop and publish government wide standards on both CBA and on RIA with generic applicability. Methodologically, the RIA standards set down in the Australian Government’s Regulatory Best Practice Handbook were recently reviewed and found to be “entirely consistent with OECD Principles for implementing best practice regulation”. The Canadian Cost Benefit Analysis Guide (2007) provides an overview of the need for and application of CBA in relation to regulatory policy. These publications can serve as useful starting points from which countries can develop a similar publication.

Special attention should be given to the relation between RIA and CBA. The latter tool is mostly applied to infrastructure projects, but CBA is in principle applicable to any policy instrument, including regulations. For instance CBAs have successfully been applied to such initiatives as road pricing and environmental legislation. Standards should include criteria for the applicability of both tools. Since CBA aims at monetary valuation of costs and benefits, while recognising the existence of factors than cannot be monetised, the criteria should specify the suitability of CBA in the light of the relative weights of the factors that can be valued in monetary terms versus those that cannot.

Interlocutors in the countries participating in the study mentioned time and again that good technical skills cannot be developed simply by reference to a handbook and therefore governments should consider developing a suite of on-line tutorials or similar

educational tools as a secondary resource which provides detailed instruction in the application of each methodology. Responsibility for developing these guidelines could be assigned to an oversight unit located under the ministry that is responsible for the business sector (usually the Ministry of Economic Affairs). The publication should be disseminated throughout the core ministries and on-line.

The challenge in implementing this reform is to ensure the rigorous application of the standards whenever line ministries move to develop options for new policy proposals with major impacts on the private sector. To this end, Australia has rules that require all proposals for new policies or policy expansion that require certain criteria related to the impact on the private sector must be provided with a regulatory impact statement (on the basis of a RIA).

Secondly, the government wide standards should position RIA and CBA as part of the broader policy development work conducted in the line ministries.

For this purpose it is important that in the first stage of every policy development process, the line ministry decides on the basis of criteria specified in the government wide standards whether the policy initiative requires special *ex ante* assessment procedures. This may concern RIA or CBA, but also an ICT gateway procedure (see Reform 9.3). If uncertain of the appropriate methodologies, line ministries can consult with the central unit tasked with government-wide oversight and technical support. If the criteria apply, the line ministry orders a RIA or CBA to be carried out, sometimes preceded by a options-stage RIA or CBA, if the policy initiative allows alternative options for the policy mix. In the Australian case the Prime Minister may grant exemption in special cases of political expediency.

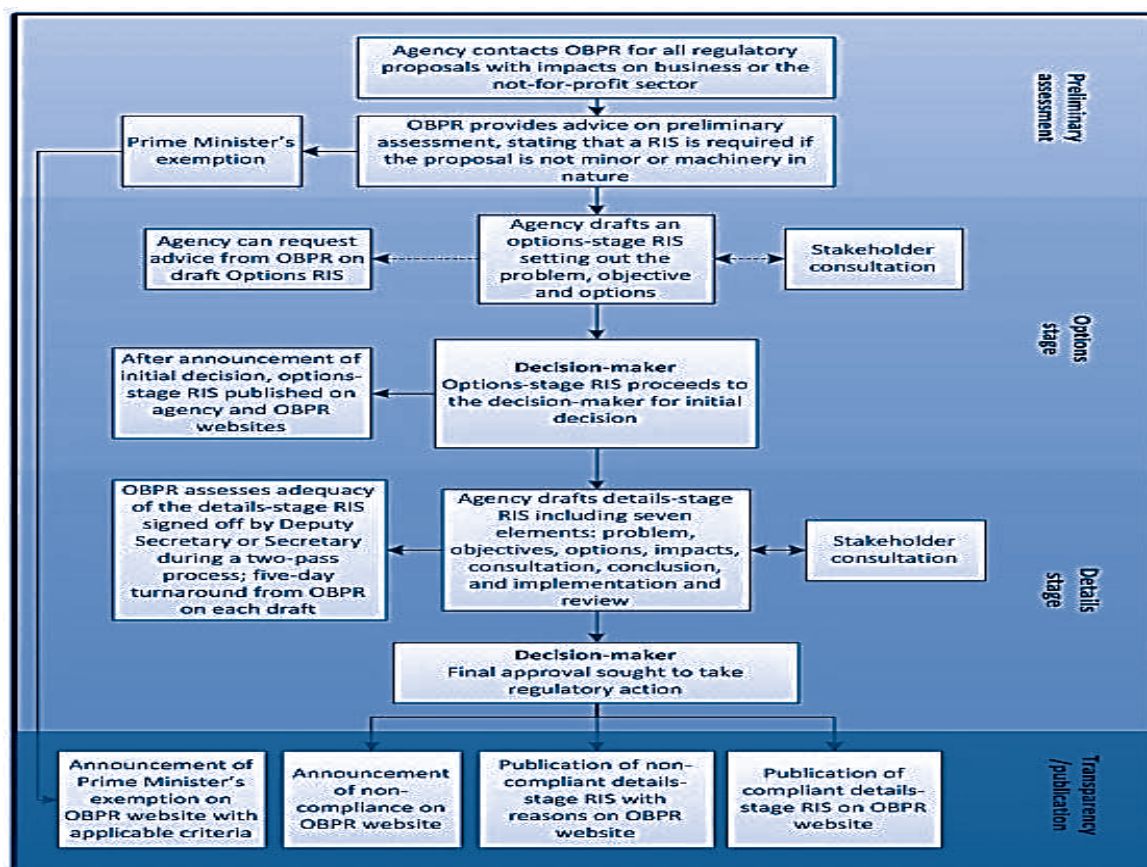
It is common practice that line ministries out-source RIA or CBA to a reputable consulting agent to ensure both technical expertise and impartiality. Once the RIA or CBA is undertaken, however, it is the responsibility of the line ministry to decide whether the policy proposal has to be submitted to the Government.

In the case of infrastructure projects, the CBA requirement is independent from the sectoral planning process. In most OECD countries, there is a long and medium-term planning process of infrastructure investment in place. These plans are often annually updated and submitted to Parliament. However, it is important that no irreversible decisions are taken on these plans before the separate projects are submitted for implementation to the Government. CBO's must be carried out at the occasion of the final decision on implementation, since economic, demographical, social and environmental circumstances are permanently changing and it is important that CBAs take into account the most recent information that affect social costs and benefits.

Once the RIA or CBA is completed it should be submitted for quality control to the oversight unit. The unit may make comments that should be part of the documentation that goes to the Government at the occasion of final decision-making. Figure 3.3 provides an overview of the Australian procedure for RIA's that illustrates the various stages of the assessment process. The Australian procedure does not apply to CBAs. However, there are strong arguments to apply a single procedure for RIAs and CBA's. First the tools are quite similar and a single procedure avoids overlap and makes it possible to co-ordinate the use of both tools. Second, using a single procedure for both forms of assessment is efficient and makes it even possible to realise savings if in a country both procedures are currently organised separately. Note that the process is divided between preliminary,

options and details stages in which the analytical requirements are increasingly sophisticated.

Figure 3.3. The RIA process in Australia



Co-ordination and steering by an oversight unit

Many OECD countries have in recent years established regulatory oversight units (OECD, 2011). Their tasks may include:

- Consulting with line ministries during development of new regulations;
- Reporting on regulatory reform by line ministries;
- Reviewing of, and commenting on RIAs of line ministries;
- Conducting RIAs of inter-ministerial regulations.

Establishing a single unit for these purposes may avoid a fragmented approach to regulatory oversight as sometimes exists in countries without a single specialist authority. The unit should consist of specialists in regulatory policy, possibly supported by a committee of officials from the legal affairs divisions of line ministries. The unit would have a technical role and should not interfere with the substantive merits of new regulation. Since the unit is per definition tasked with the review of CBAs of new regulations, it seems logical and efficient that oversight on the application of CBAs in

general is entrusted to the unit (also if it concerns the CBA of other policy proposals than regulations).

Countries are divided on the question of where to locate this specialist unit, although it is invariably located in an economic focused ministry. For examples, the specialist unit is located in the Ministry of Economic Affairs in the Netherlands, in the Treasury Board Secretariat in Canada, and in the Treasury in the UK. In Australia, responsibility for the regulatory framework is split between units in two ministries: the Productivity Commission (an agency of Treasury) establishes regulatory policy and undertakes policy focused regulatory reviews as mandated by the cabinet. In contrast, the Office of Best Practice Regulation (Ministry of Finance) implements the system by providing oversight, co-ordination and specialist advice to line ministries (see Box 3.1).

Box 3.1. The Office of Best Practice Regulation

The OBPR plays a central role in helping Australian Government departments and agencies to meet the government's requirements for best practice regulatory impact analysis, and in monitoring and reporting on their performance. The OBPR promotes the Australian Government's objective of effective and efficient legislation and regulations. Its functions include:

- Advising agencies on whether a Regulation Impact Statement (RIS) is required;
- Examining details-stage RIS and providing comments to agencies
- Examining details-stage RIS and advising decisions-makers whether the statements are adequate in terms of the government's best practice requirements
- Advising agencies on assessing business compliance costs and maintaining the Business Cost Calculator as a regulation costing tool
- Providing training and guidance on RIS
- Providing technical assistance on CBA and consultation.

Evaluation and reduction of regulatory burdens of existing regulation

Evaluation of existing regulation is not a form of *ex ante* assessment. However, there are connections with RIA which need consideration.

RIAs look at proposals for new regulation. Since they are a relatively recent phenomenon, it is not ensured that existing regulation would have passed the scrutiny of RIAs when it was established. Moreover, economic, social, demographical and environmental circumstances have changed over recent decades, and it is not sure that existing regulation would currently pass the scrutiny of a RIA even if it would have done so in the past. For this reason many governments have undertaken operations to evaluate existing regulations.

It is important to distinguish between two kinds of *ex post* evaluation of regulations. The first is aimed at effectiveness and efficiency, the second at regulatory burdens for businesses, citizens and private and public service delivery institutions.

For evaluation of the efficiency and effectiveness of existing regulation no special arrangement is necessary. This is fully covered by the general arrangement for policy evaluation (Reform 3.5). A single, general approach has the advantage that the regulatory

instrument can be more easily compared with other policy instruments such as subsidies, tax instruments, and the delivery of services in kind.

The second mode of *ex post* regulatory evaluation requires a more top-down approach, as line ministers have little incentives for the reduction of regulatory burdens and are rarely held accountable by Parliament for their efforts in this respect. This situation is somewhat comparable to that of budgetary policy, where ministers have little incentives for developing good savings proposals. This implies that special procedural requirements, comparable to those of spending reviews (see Reform 7.6 in Chapter 7) should be put in place to generate such proposals. Such requirements should insure that the line ministries can bring their expertise and take part in the development of proposals to reduce regulatory burdens, but cannot dominate the process or veto the proposals of other ministries or external experts.

However, there is no full analogy with budgetary policy, since in the case of regulatory burdens there can be no trade-off between regulatory instruments and there is no permanent need to weigh the costs of existing policy against new policy and tax relief. For this reason operations to reduce regulatory burdens have generally been set up as one-off operations (see Reform 7.6).

A one-off regulatory review focused on evaluating the cumulative impact of regulatory stock should be conducted within a limited period of some five years and not much longer on penalty of losing impetus and effectiveness. A temporary arrangement could be set up under the supervision of the regulatory oversight unit. The temporary arrangement should be set up in a similar way as spending review procedures (inter-ministerial working parties, independent chairmen, secretariat with oversight ministry, external experts, public reports, etc.). The measurement of regulatory burdens should follow a pragmatic approach. For administrative burdens the standard cost model (endorsed by the OECD) can be used. Compliance costs should be estimated by use of robust, approximate estimation methods. No attempts should be made to estimate benefits. The recommendations for the conduct of regulatory review published by the OECD in 2012 suggests a “*whole-of-government*” approach to regulatory reform, with emphasis on the importance of consultation, co-ordination, communication and co-operation to address the challenges posed by the inter-connectedness of sectors and economies (OECD, 2012c).

Feasibility of the reform

Most OECD countries have in recent years implemented reforms aimed at various forms of *ex ante* analysis. However, the approach to these reforms is often fragmented and leads to overlapping procedures and inefficient organisational structures. In addition the compliance with these procedures is not always ensured, often because the urgency of policy initiatives makes it politically impossible to apply these procedures according to the standards that were set for them. It is therefore important that countries focus on simplification and merging of procedures, avoiding overlap and fragmentation and concentration of oversight in a single unit. Only if procedures are clear and simple, can RIAs and CBAs provide effective scrutiny over policy proposals.

Reform 3.7. A more consistent division of policy responsibilities between central and sub-central governments

Characteristics of the reform

This reform consists of revising the distribution of policy tasks between levels of government to ensure greater coherence and reduce unnecessary overlap within each policy area. This will strengthen policy development capacities within each policy area, and provide a substantial reduction in earmarked grants and associated supervisory administration from central government. Decentralisation of tasks should not be made conditional on amalgamation of subnational governments. This reform is contingent on existing constitutional and governance arrangements and should proceed from a review of existing arrangements in which coherence within each policy area should be the prime assessment criterion.

Where did it occur?

Efforts to clarify and streamline the distribution of policy responsibilities across levels of government are an ongoing objective of government and constitutional reform in many countries participating in this study. Specifically, this reform draws on experiences from the Netherlands, Australia, Canada and the United Kingdom. These countries represent different constitutional arrangements (federal and unitary systems), administrative histories and cultures, and offer different approaches.

Analysis

Problems caused by current task divisions

The overall division of policy responsibilities between central and subnational governments in countries participating in the study is patterned by the combination of constitutional, political, financial and practical histories. Rarely is the distribution of policy tasks over levels of government designed according to a single set of principles and then frozen in time. Nor is the distribution of policy tasks similar across different countries. For example, in Australia, Canada, Spain and the US responsibility for developing and delivering policy in the areas of health, education and transport is divided across two, sometimes three levels of government. In the UK, Sweden and Denmark these policy areas are divided between central and local government. In the Netherlands responsibility for social security and welfare programmes is divided between central and local governments, whereas in Australia the national government has singular responsibility for this policy area. As a consequence there is significant variability and complexity in the prevailing distribution of policy tasks within and between countries participating in the study,

Mechanisms designed to manage policy fragmentation and inconsistency, add to the complexity of governance and are often sub-optimal from a budgetary and administrative perspective. Unclear task assignment between levels of government are likely to reduce the capacity for cohesive policy development within a policy area, and are likely to increase competition between policy advisers and distance policy deliverers from the processes of policy development (see Reform 3.4). Separating responsibility for policy design and implementation from revenue raising and funding is likely to encourage free-riding and cost-shifting within a policy area, and consequently create difficulties in managing public finance and budget ill-discipline. The mechanisms designed to ensure

policy coherence across different levels of government often create a complex web of intergovernmental administrative controls. Taken together, these factors create policy development arrangements that are unnecessarily complex, overlapping and fractured (see Reform 3.4).

Aims of the reform

Consolidating responsibility for policy development within a single level of government aims to strengthen policy effectiveness. Furthermore, in reducing overlap and duplication of purpose across levels of government the reform will improve efficiency within each policy sphere. The reform will also contribute to efficiency by simplifying funding arrangements. In particular, the reform will make it possible to eliminate earmarked grants and the administrative oversight arrangements typically accompanying such grants and replace them by simpler financing instruments such as tax sharing and general purpose and block grants.⁵ In sum, establishing a more logical and transparent separation of tasks between central and regional governments, this reform has the potential to deliver significant value for money savings across the government sector, while also enhancing policy capacity.

Two roads toward reform

Reforming the division of policy responsibilities among levels of government can follow two roads: pragmatic or normative. A pragmatic approach aims to improve the existing distribution of policy responsibilities among levels of government by making it more logical and coherent. This approach will be accompanied by a clean-up operation in the area of earmarked grants and administrative arrangements in policy areas where more government levels are now involved. The second, more normative, approach to restructuring policy responsibilities aims at a more fundamental review that develops options for the transfer of policy tasks from central to local government in areas that are now exclusively the domain of the central government, or vice versa.

Recent reform efforts in the Netherlands provide an example of the first approach. A spending review conducted in 2010 developed an option for the transfer of policy tasks in the areas of social services, enduring care and youth care to local government. In contrast “cure” should remain a task of central government. The areas of spatial and economic policy should be concentrated at the provincial level. This option drew confidence from the success of previous reforms where decentralising social assistance⁶ led to savings in the order of 25% of the costs. Further decentralisation along this line was proposed by the Spending Review 2010 “Long-Term Care” (Government of the Netherlands, 2010b).

This approach is likely to retain some degree of fragmentation and incoherence within policy areas, which may limit some of the possible benefits for policy development. For example, Australia’s recent efforts to reform health policy have been hampered by the fact that responsibility for primary care (essentially hospitals) lies with state governments, while community care (health rebates) and pharmaceuticals lies with the national government. Repeated efforts to develop a coherent national agenda for health reform have been hampered by the division of responsibilities within this policy area.

In the second approach to reform, the direction of change – centralise or decentralise – will be determined largely by the theoretical framework underpinning the review. So, for example reviews informed by the subsidiarity principle will say that tasks should be attributed to the level closest to citizens and, in view of varying preference patterns, the optimum level for allocation. In most countries this is likely to translate into

a programme of decentralisation in most areas of social policy including health, education and transport. The central government is likely to retain responsibility for international trade, defence, and customs for example.

The UK government adopted a normative approach when restructuring policy responsibility with a philosophical agenda dubbed “localism”. Under these reforms, all departments of central government were required to devolve the “power and finances of government to local government, public service professionals and communities” (UK Government, 2010: see Box 3.2).

Box 3.2. Localism in the UK

The UK government introduced legislation setting out a general policy of decentralisation to be implemented through six “essential actions” (UK Government, 2010:2-3)

Six essential steps for implementing “new localism”

1. **Lift the burden of bureaucracy:** The first thing that government should do is to stop stopping people from building the Big Society.
2. **Empower communities to do things their way:** Getting out of the way is not enough. Government must get behind the right of every community to take action.
3. **Increase local control of public finance:** Government must will the means, as well as the ends, of community power.
4. **Diversify the supply of public services:** Local control over local spending requires a choice of public service providers.
5. **Open up government to public scrutiny:** Public service providers should be subject to transparency not bureaucracy.
6. **Strengthen accountability to local people:** Public services shouldn’t just be open to scrutiny, but also subject to the individual and collective choices of active citizens.

The specific reforms were based on reviews undertaken by the relevant department of central government.

A progress report conducted in December 2012 shows that progress toward decentralisation differs considerably between departments (UK Government, 2012). Of the twelve departments rated out of 5 stars, two received 4 stars, eight received 3 stars, and two departments were allocated just 2 stars. The report findings suggest a key indicator of successful decentralisation is whether or not public institutions currently exist in that policy area so that policy and funding responsibilities can be easily (and legally) devolved. So, the Departments of Local Government and Education which were judged as most successful reformers were able to devolve policy responsibilities relatively simply to councils and schools respectively. In contrast the department of sports and recreation had to work with a plethora of government, private and community organisations, many of whom were competing among each other and lacked basic governance structures.

Source: UK Government (2010, 2012)

Decentralisation conditional on amalgamation?

More cohesion in task assignment will often imply more decentralisation, because tasks that are now mostly carried out at a sub-central level of government will henceforth be entirely carried out at the sub-central level. However, there is a strong feeling in many

countries participating in the Value for Money study that decentralisation of policy responsibilities should be conditional on reducing the number of sub-central governments at the level of state and local government. There are also more theoretical arguments that lend support to the view that decentralisation should only be considered when sub-central governments are large enough. If local governments are small (particularly in geographical size), citizens and businesses may shop around to neighbouring jurisdictions to get better services at no costs to them. Similarly, small governments may not be able to realise economies of scale in service delivery, which may also affect service quality. However, these arguments are subject to debate. If both suburban and metropolitan jurisdictions resist centralisation and amalgamation, it is hard to argue for such policies on the basis of external effects. Similarly, a sub-optimal scale of service delivery makes citizens and businesses suffer (from high taxes, or savings on other services). Again, if citizens nevertheless resist centralisation and amalgamation, it is hard to argue for such policies on the basis of economies of scale. Apparently citizens are willing to pay a price for decentralisation and the maintenance of their existing jurisdictions and particularly for keeping them small and relatively responsive to citizens' concerns.

It can be observed among OECD member countries that there are different political cultures regarding amalgamation. In some countries, the basic attitude is that it is up to the citizens and their existing local councils to decide about amalgamation. This is the prevailing attitude in Mediterranean countries such as France, Italy and Spain. These countries are often characterised by a lively local democracy and directly elected mayors or governors. In northern Europe and in Australia, decisions on amalgamation of local government are seen more as a concern of the central and state governments respectively. In these countries the experience with amalgamation operations is mixed. In Denmark, a far-reaching government-led amalgamation operation for municipalities was successfully completed in 2007. This operation reduced the number of municipalities from 271 to 91 and the number of regions from 13 to 5. The Netherlands has a long history of failed amalgamation operations. Recently it was proposed to reduce the number of municipalities from 430 to 100-150 or even to 25-30, and the number of provinces from 12 to 5-8 or even to 0 (Government of the Netherlands, 2010a). The current cabinet has adopted a more modest proposal in its government programme, but the chance that this will be adopted is decreasing.

Overall the experience of countries participating in the study suggests that policy decentralisation need not be conditional on amalgamation. If small municipalities or historical provinces or regions cannot fulfil decentralised tasks as efficiently or as well as larger units do, the drive for amalgamation will automatically come from below. Jurisdictions will seek regional co-operation or will decide to amalgamate on their own initiative. Alternatively, citizens of these governments will need to pay for a sub-optimal scale, or accept a lower service level. The fact that some municipalities and some provinces/regions are not believed to have the right scale for being entrusted with tasks now performed at the national level is not always a good reason to refrain from decentralisation. What matters is whether municipalities, provinces and regions are themselves in favour of decentralisation. If that is the case, it is hard to use the scale argument or the external effects argument as an excuse to halt it.

Feasibility

Existing policy arrangements, constitutional limits and political coherence within each country and each policy area will determine the feasibility and impact of this reform.

Experience from countries participating in the study points to two major issues that must be resolved when undertaking reforms to clarify the distribution of policy responsibilities between levels of government. First, the overall road or approach to consolidation or decentralisation must be decided: should the programme of reform be built around a pragmatic “clean up” of existing arrangements, or a more fundamental review driven by normative principles? Second, the question of whether decentralisation of policy responsibilities should be contingent on the amalgamation of local or regional governments must be resolved.

Given that the degree of fragmentation within a policy area differs considerably within and across countries, reform efforts may begin with a scoping review that maps out the current policy, administrative and funding arrangements in each policy area, thereby identifying the policy areas in most conducive to reform.

Notes

1. See, for instance, Advisory Group on Reform of Australian Government Administration (2010).
2. In some countries (e.g., Ireland, and currently in Hungary), the IFI is charged with simply approving or disapproving the official forecasts, but without presenting a forecast of its own.
3. In view of European legislation that requires a national authority to be charged with the assessment task, the Dutch government has recently decided to attribute the assessment task to the Council of State (an existing independent advisory body for the Government). A similar consideration in Sweden has led to the establishment of the Fiscal Policy Council apart from the existing National Institute of Economic Research.
4. This reform focuses on using RIA and CBA to strengthen policy development rather than as a means of achieving a specific policy objective of reducing regulation in favour of other policy instruments. These issues are partly addressed in previous reforms of this chapter and more extensively by the Recommendation of the OECD Council on Regulatory Policy and Governance adopted by the Council of the OECD (2012c). For technical advice on the conduct of RIA and current best practice principles we refer readers to the OECD Guiding Principles for Regulatory Quality and Performance which are designed to “provide guidance to member countries to improve regulatory policies and tools, strengthen market openness and competition and reduce regulatory burden”. For the practice within individual countries we refer to the regulatory reviews undertaken by the OECD and found at www.oecd.org/gov/regulatory-policy/49990817.pdf
5. A block grant is a grant intended for a limited number of purposes, which is not earmarked (and thus can be used for other purposes).
6. These are social security benefits for unemployed people who are not eligible for other social security benefits.

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Chapter 4

Policy execution

This chapter presents reforms in the area of policy execution. The organisation of policy execution is very diverse. There is little similarity across countries. Within countries the organisational pattern tends to be rather unsystematic. The analysis in this chapter is based on two distinctions between organisations inside central government: 1) between the State and other organisations with legal personality (private and public non-profit organisations), and 2) between core ministries, arm's length agencies and independent agencies. These distinctions are recognisable in all countries participating in the study, but strict criteria for the use of the various organisational forms are often lacking or are not systematically applied.

A more systematic approach could potentially lead to large savings. This chapter presents four reforms that aim to ensure a more consistent task assignment to arm's length agencies, independent agencies and private non-profit institutions. Another reform concerns the merger and co-operation of executive agencies with similar tasks. Finally one reform looks at the foreign service as an executive organisation with special characteristics.

Introduction

What is policy execution?

This study is based on the distinction between four tasks of government:

- policy development;
- policy execution;
- administrative regulation and supervision;
- provision of support services.

This chapter is devoted to policy execution. Since the distinction between the tasks is sometimes subtle, some further explanation on the demarcation of policy execution is in order.

Governments execute their policies making use of three policy instruments¹:

1. financial instruments;
2. regulation;
3. service delivery in kind.

Financial instruments at the revenue side are taxes². Taxes can flow into the general fund or into special funds earmarked for the financing of specific expenditures. They can be imposed with the sole purpose of financing expenditures or with the additional purpose of constraining consumption of certain goods (regulatory taxes). Financial instruments at the expenditure side include grants, subsidies and social benefits. Grants are transfers to legal persons outside the State (international organisations, sub-national governments, private corporations, public non-profit institutions). Subsidies are transfers to legal persons outside the state that affect the price of goods sold in private markets. They typically cover less than 50% of the costs (otherwise they would be grants). Social benefits are transfers to family households in virtue of social security legislation.

Regulations put direct constraints on the purchase or sale of goods in the market. They can be implemented in law (acts of the legislature) or in by-laws (acts of the government or the minister). In some cases regulation can be issued by administrative regulatory authorities (administrative regulation).

Service delivery in kind consists in the provision of goods. They can be collective goods (infrastructure, army, police, penitentiary institutions, etc.) which are available to the citizenry as a whole, or individual goods (education, health, social and cultural services). If they are individual goods, they are made available free or at prices that cover less than 50% of the costs. The government may also engage in commercial production via state owned enterprises (SOE), but this is not a government task in the sense of this study (and the financial flows concerned are in the national accounts not recorded in the general government sector, but in the corporate sector).

In order to implement these instruments the government needs executive organisations. As far as financial instruments are concerned, taxes need to be assessed in individual cases. For the general fund taxes, this task is performed by the tax service. For certain earmarked taxes, separate organisations may exist to perform these assessments.

Grants, subsidies and social benefits need to be awarded in individual cases. This involves eligibility testing. These tasks can be attributed to various kinds of government organisations and are seen as executive tasks.

Many regulations attribute authority to government organisations to issue administrative decrees in individual cases, mostly in administrative law, but sometimes also in civil and criminal law. These decrees can have the character of licenses and permits (to do something that otherwise would be prohibited, in general or in a concrete case), concessions (to exploit a government property on a commercial basis), or admissions (recognising somebody in a certain quality, such as a notary or a car-driving school). The issuance of these decrees is considered as policy execution, unless it is attributed to a special administrative regulatory organisation, in which case it is considered as administrative regulation and supervision (see Chapter 5).

The delivery of services in kind, both collective and individual goods, is always considered as policy execution. Consequently, the army, police, the road construction agency, the penitentiary institution, the hospital, the school are seen as executive organisations.

Executive tasks can be divided in administrative service delivery and service delivery in kind. Execution of financial instruments and regulations is considered as administrative service delivery, provision of individual and collective goods in kind is considered as service delivery in kind³.

How is policy execution organised?

Looking at the organisation of policy execution in OECD countries, the most conspicuous feature that comes to the fore is diversity. There is very little similarity in organisational patterns across countries. Some countries have devolved policy execution mostly to special executive organisations, but there is little international comparability between the types of these organisations in terms of their autonomy and legal status. Also the scope of ministerial responsibility with respect to their task performance is widely different between countries.

A second observation is that also within countries the pattern tends to be rather unsystematic. Very few countries have strict criteria for the task attribution to different kinds of organisations and for their legal status. Nevertheless for the purpose of international comparative analysis it is necessary to work with a taxonomy that is applicable to all OECD countries.

For the purpose of the present study, two distinctions in organisations within the central government sector (in the sense of the national accounts⁴) have been made.

The first distinction is that between the State⁵ and the public non-profit institutions. The latter belong to the central government sector in the sense of the national accounts but have their own legal personality and thus do not belong to the State.

The second distinction is that between core ministries, arm's length agencies and independent agencies within the central government. This distinction has been explained in Chapter 2 in connection with employment statistics. Central government employment includes apart from these three types of organisations, also the so-called "High colleges of State". These include the household of the Head of State (royal household, office of the President), the Parliament, the Judicial Branch (the courts⁶) and the Supreme Audit

Institution. The armed forces are considered here as a separate branch of the core ministry of Defence (not an arm's length or independent agency).

These distinctions lead to the following taxonomy of executive organisations.

Table 4.1. Taxonomy of the organisation of central government

Organisations	Administrative or service delivery in kind	Type of task	Some examples*
High colleges of State	Neither administrative nor service delivery in kind	Not split out	Head of State Parliament Judicial Branch Supreme Audit Institution
Core ministries	Administrative	Policy development	Tax policy division
		Policy execution	Tax service
		Administrative supervision and regulation	Education Inspectorate
		Support services	Ministerial support services
	Collective service delivery in kind	Policy execution	Armed forces
Individual service delivery in kind	Policy execution	Foreign service (consular affairs, trade promotion)	
Arm's length agencies	Administrative	Policy execution	Executive Service Education
		Administrative supervision and regulation	Inspection work and Income
		Support services	Work agency (shared service centre)
	Collective service delivery in kind	Policy execution	Infrastructure agency
	Individual service delivery in kind	Policy execution	Centre for the Promotion of Import from Development Countries
Independent agencies without legal personality	Administrative	Policy execution	Electoral council
		Administrative supervision and regulation	Competition authority
Independent agencies with legal personality (public non-profit institutions)	Administrative	Policy execution	Social Benefit Administration
	Individual service delivery in kind	Policy execution	Universities, museums, etc.

Note: * The examples are all from the Netherlands.

Some observations regarding this taxonomy are necessary:

- Many OECD countries have not systematically devolved all policy execution to agencies implying that administrative policy execution is often still in the core ministry (the tax service for instance). Also, supervisory and regulatory authorities, including inspectorates, are often still in the core ministry. Support services are always for a large part in the core ministries, even in those countries that have more or less systematically devolved policy execution, in particular the support services for the ministry as a whole (shared service centres are often devolved to agencies). Furthermore, the armed forces are never devolved. Individual service delivery by core ministries has become scarce, but there are still examples (see Table 4.1).
- Arm’s length agencies do not exist in all countries, but if they do exist, they are typically not tasked with policy development, but rather with policy execution (administrative and collective service delivery), administrative policy supervision and regulation and support services. Arm’s length agencies tasked with individual service delivery are scarce. A Dutch example is the Centre for the Promotion of Import from Developing Countries under the Ministry of Foreign Affairs that supports businesses from these countries to expand their exports to the EU.
- Independent agencies without legal personality are typically tasked with administrative policy execution (for instance the electoral council) or with administrative regulation and supervision (for instance the competition authority). The boundary line with independent agencies with legal personality (which are public non-profit institutions) is fluid. The attribution of legal personality is very unsystematic in most OECD countries.
- Concerning public non-profit institutions, the essential dividing line is between a) administrative agencies, of which there are many examples in most countries, for instance “Executive Non-Departmental Public Bodies” in the UK, the “State Operators” (“*Opérateurs d’État*”) in France and many of the “Autonomous Organs of Administration” (“*Zelfstandige Bestuursorganen*”) in the Netherlands); and b) suppliers of the services in kind (for instance universities, hospitals and providers of social services). It should be emphasised that all these organisations are considered as belonging to central (and general) government, meaning that they are controlled and financed more than 50% by government. If financing is organised in a different way, for instance through health care insurance institutions, they may belong to the corporate sector and are not considered as general government organisations.

The trend of recent reforms

In many OECD countries the picture of organisations in central government outside the core ministries is complicated. They have different legal statuses and different degrees of autonomy. Sometimes they have legal personality, sometimes not. Often there are no clear criteria for the attribution of a certain legal status or of legal personality. This is also true for the countries included in this study. However, a few countries have started to remedy this state of affairs and are trying to bring more order in the picture. In view of vested interests it is usually easier to apply criteria to new organisations than to change the status of existing organisations. The UK has put up criteria for the different kinds of organisations, building forth on the existing pattern, but has not yet fully applied these

criteria to existing organisation. France has carried out studies of the existing pattern of organisations and has embarked on an operation to bring more order in the pattern. The Netherlands has made various attempts to bring more order, but these attempts have partly failed.

In spite of these mixed experiences, countries are generally aware that reforms in this area are important and can potentially lead to large savings. The most common problems are:

- Policy execution has not been systematically devolved to arm's length agencies, much execution remains in the core ministry;
- There are no strict criteria for independent agencies; although independent agencies are not protected against government interference in cost control (only in their executive policies), in practice there is often less scrutiny;
- There are no strict criteria for attribution of legal personality. As a consequence many administrative authorities have the status of public non-profit institutions (outside the State). This has consequences for the financing of these authorities, cost control and the applicability of standards of operational management that apply to State agencies;
- There are no strict criteria or clear policies on the attribution of service delivery (both collective and individual) over agencies, public non-profit institutions and private non-profit institutions.

This chapter describes a number of reforms that have taken place in several countries included in the study, in order to remedy these problems. Reforms in these areas can lead to substantial savings, since they often lead to stricter cost control and less opportunities to escape scrutiny by core ministries. Countries that have been active in this area include Australia, Denmark, France, the Netherlands, and the UK. Sweden is a special case because of the traditional split between core ministries and agencies that has existed in that country for centuries. Other countries have often refrained from looking at Sweden because the Swedish arrangements were thought too exceptional and too different from the national organisational pattern. It will be argued in this chapter that this view is too simple. Now that many countries have devolved policy execution to arm's length agencies, the Swedish example has become particularly relevant and inspirational. Sweden has accumulated more experience with arm's length agencies than any other OECD country, and has adjusted its steering and control arrangements over a long period. This should be a reason to pay close attention to Sweden, and the Swedish example figures prominently in this chapter as well as in Chapter 12 on the steering of agencies (although the word "reform" is a bit peculiar in relation to Sweden, as it sometimes concerns arrangements that have been introduced long ago).

This chapter describes 5 reforms. The first concerns the systematic devolution of all kinds of policy execution (administrative services, services in kind) to arm's length agencies. The second concerns the use of arm's length agencies to organise common executive process units that provide services to several ministries. The third concerns the role of independent agencies and looks at the Swedish example for how the risk of diminished cost control and scrutiny can be minimised. The fourth concerns the role of public non-profit institutions in policy execution and looks at the consequences of transferring their tasks to the private non-profit sector. The last reform looks at the particular case of the Foreign Service as an executive organisation. The reason for

considering this particular case is that in countries that have systematically transferred executive tasks to arm's length agencies, the Foreign Service is sometimes the only unit inside a core ministry that still performs individual service delivery, particularly in the area of trade promotion. Arm's length agencies under the Ministry of Foreign Affairs are sometimes also the only arm's length agencies that perform individual service delivery, also in the area of trade promotion (see examples in Table 4.1).

Reform 4.1. Role of arm's length agencies

Characteristics of the reform

The reform consists of devolving all executive tasks of central government to agencies that have their own financial administration. Since the largest share of central government employment is used for the conduct of executive tasks this will lead to a reduction of employment in (core) ministries of up to 95%, compared to a situation in which all executive tasks are conducted by the ministries. Apart from policy execution tasks, arm's length agencies can also be tasked with the provision of support services for the ministry and its agencies, or, as shared service centres, for several ministries or for ministries and local governments.

Where did it occur?

A country that has a long tradition in policy execution by arm's length agencies is Sweden. In that country policy execution has always been separated from policy making, by way of constitutional principle. However, the Swedish example has not been the most important inspiration for the trend of separating policy execution from policy development that started in the UK in the 1980s with the so-called "Next Step agencies". That trend was mostly inspired by the ideas of New Public Management. The UK and other Anglo-Saxon countries always had known administrative authorities on arm's length distance from government, but the new trend envisaged explicitly the separation of execution from policy making across the board by way of principle of public administration. This idea was gradually taken over and explicitly endorsed by a number of OECD countries. In the Netherlands the idea was adopted leading to a gradual devolution of all executive tasks to agencies (the last executive unit still in a ministry being the tax service).

Analysis

Arm's length agencies in the 1990s

The devolution of executive tasks to arm's length agencies was one of the core ideas of New Public Management (see Chapter 1). The main motivation was the aim to introduce incentives in production of public services that would ensure the same level of efficiency and quality of services that are achieved in competitive markets, while maintaining government ownership and control. As it turned out this aim could be endorsed by both right leaning and left leaning governments, as long as it concerned basic public services where government ownership and control was seen as necessary.

The original concepts that inspired first the "Next Step agencies" in the UK, and subsequently the agency movement in many other OECD countries (Australia, New Zealand, the Netherlands, Denmark, Finland) were twofold:

- a results oriented governance model;
- special facilities in operational management (exemptions to the standards applying to core ministries, particular in the area of financial management).

The results oriented governance model was based on the view that executive units were producers of services comparable to private service producers. They could hence be steered in the same way: on the basis of integral cost prices for their services. In this view core ministries were seen as the purchasers of their services in the light of prices and quality (the “provider-purchaser” model). This implied that agencies had to define their services and provide good information about quality. Financing of agencies was conceived in this view as negotiating budgets and performance. Quantity and quality of performance needed to be measured. Financing contracts between core ministries and agencies needed to be stated in terms of budgets and performance indicators. In order to calculate integral cost prices, the financial administration of agencies had to be based on accrual accounting. This would allow the integration of capital costs and depreciation in the cost price of services. Core ministries had to abstain as far as possible from interference in the production process of agencies. This was to be delegated to the agency managers, including decision-making over the input mix (salaries, procurement, operational investment) and including operational management (the use of operational means, in particular financial resources).

Agency managers were made accountable for performance, but they would acquire more freedoms in the area of operational management. In the beginning, there were various kinds of experiments with exemptions to government wide “standards of operational management” (see Chapter 6), particularly in the area of financial management. The most important ones were that agencies were allowed to build up financial reserves, held at the Treasury (unlimited carryover of financial resources) and that they were allowed to borrow from the Treasury. This would allow them to manage their own capital goods, including investment and sale of capital goods. In connection with these facilities the agencies were supposed to use a financial administration based on accrual accounting.

The original view was that gradually all executive tasks of central government would be devolved to agencies. Task transfer to arm’s length and independent agencies together, would lead to a large reduction of administrative employment in the core ministries, in the order of 80-95%⁷. As a consequence the core ministries would become much less important from the point of view of operational expenditures. It was largely accepted that core ministries could not be managed to the same extent as agencies on the basis of performance, but in view of their small scale this would become less problematic. The big efficiency gains had to come from the agencies. This would lead to large savings. In several countries there were attempts to link the devolution of tasks to agencies with savings targets. Executive units that would become agencies were freed from certain standards of operational management under the condition that they would realise efficiency savings. In other countries the link was not so direct, but governments sometimes committed to regularly reporting on efficiency savings in agencies at the request of Parliament or the Supreme Audit Institution. Parliaments were often sceptical about devolution of executive tasks to agencies, for fear of losing authority over agency spending.

The agency movement of the 1990s was hardly influenced by the Swedish example. This is curious because in Sweden the separation of policy preparation from policy

execution is anchored in the constitution for centuries. However, the background of the Swedish model has nothing to do with results oriented governance or with New Public Management. In Sweden the separation between both tasks of government is based on particularly strict interpretation of the rule of law. In this interpretation, the application and interpretation of the law is generally entrusted to the agencies, which have a certain kind of autonomy from the government and which, for their decisions in individual cases, can only be corrected by the Courts. The idea that ministers cannot give instructions to agencies in individual cases was not part of the agency movement of the 1990s, but it is essential for the Swedish model. On the other hand the results oriented steering model, although not part of the Swedish model had an impact on the Swedish practice of agency steering once the agency movement started in the 1990s. Devolution as such was not relevant for Sweden, because it already existed, but results oriented governance and facilities in the sphere of operational management were part of the reforms adopted by Sweden in the 1990s similarly as in other OECD countries.

Implementation of the agency model

United Kingdom

In the UK the agency model was introduced by the Thatcher cabinet following a 1988 review of the Civil Service led by Sir Robin Ibbes under the title “Improving Management in Government: the Next Steps (UK Efficiency Unit, 1988). The aim of the review was to seek recommendations to improve the management and delivery of government services. The government accepted the main recommendations of the review which included disaggregating ministries into distinct agencies to carry out the executive tasks of government, with a greater focus on delivery of services and the attainment of specified results. Agencies would be “semi-detached” from ministries and headed by a Chief Executive with freedom to manage operations in order to meet objectives and targets set by the agency’s parent ministry. Starting with 3 agencies in 1988 the number of agencies increased to 138 in 1997. By the mid-1990s the agency model had become the principal organisational type for central government public service delivery (Cabinet Office, 2006). Since then the number has decreased a bit to 84 in 2010, mostly through mergers and privatisations⁸.

Total expenditure of all arm’s length agencies amounted to over GBP 18 billion in 2003 (James, Moseley, Petrovsky, Boyne, 2011). There are three kinds of financing arrangements: 1) agencies that are financed on a fully funded basis have both their revenue and expenditure on budget and approved by the Government and Parliament; 2) agencies that are financed on a net funded basis only have net government contribution and expenditures funded by that subject to government and parliament approval; 3) agencies are free to expand their expenditures if they collect additional revenues. Trading fund financing implies that an agency finances its operations mostly from its own revenues or is entirely self-financing. Trading funds are free to raise revenue from customers and alter services according to customer demand. Only the net government contribution to trading funds is subject to Governmental and Parliamentary control.

Arms’ length agency employment reached 285 000 (persons employed) in 1997. This amounted to 60% of the Home Civil Service. This grew further to 303 000 (FTEs) in 2009, amounting to 62% of the Home Civil Service. Independent agencies (Non-Departmental Public Bodies, see Reform 4.3) employ 111 000 civil servants (persons employed) in 2009 (Elston, 2011). Agencies are relatively evenly spread among ministries. Eleven ministries have one or two agencies, four ministries have 3-5 agencies,

and 2 ministries have more than 5 agencies. Next to the owner ministry many agencies have other client ministries that co-finance the agency.

The vast majority of agencies focus on delivering services (both administrative services and services in kind), while a smaller number carry out administrative supervision and regulation.

Arm's length agencies have no legal personality and are part of the State. The governance structure of arm's length agencies can vary, but the model employed must be set out in an agency's framework document. Each agency must have a Departmental Sponsor, envisaged as a senior civil servant who acts as the main source of advice to the Minister on the performance of the agency (the so-called "Fraser figure", after the chairman of a Cabinet Office report; Cabinet Office, 2006)⁹.

The Netherlands

In the Netherlands the first arm's length agencies were established in 1994. Since then some 3 new agencies have been added per year. In 2012 there were 39 agencies, and apart from the tax service, most policy execution had by then been devolved to agencies.

Total benefits (agencies use accrual accounting and thus have benefits rather than revenues¹⁰) increased from EUR 214 million in 1994 to EUR 10 billion in 2012. All agency costs and benefits are specified in the so-called agency paragraph of the budget chapters, and thus subject to approval by Government and Parliament.

Total employment in 2012 is 54 000 FTE or one third of civil central government employment excluding police and educational institutions (independent agencies employ another 40 000 FTE; remember further that the tax service (30 000 FTE) is not an agency. Of these 54 000 FTE 91% percent is employed by the 17 largest agencies and 9% by the other 22 agencies.

Arm's length agencies are strongly concentrated in 4 ministries: Interior, Economics and Agriculture, Safety and Justice and Health, Welfare and Sport, but each ministry has at least one agency.

Of the 39 agencies, 15 work for one ministry, 11 work for 2-3 ministries and 13 work for more than 3 ministries. In total the costs of agencies are financed for 71% by the owner ministry, for 20% by other ministries and for 9% by fees from third parties.

Similarly as in the UK, the large majority of agencies focus on delivering services (both administrative services and services in kind), while a smaller number carry out administrative regulation and supervision (inspectories) or provide support services.

Arm's length agencies have no legal personality and are part of their owner ministry. Their task is defined in a ministerial decree. In each ministry the task of supervision is assigned to the Finance Directorate. This task includes: the control of requests for investments and loans, the control of annual reports and budget requests and approval of fees.

Recent developments

a. The results oriented governance model

Output is hard to define and heterogeneous. Financing of output then becomes illusory. In addition politicians continually change their minds on what has to be

produced. This is logical, because political preferences change, insights in the usefulness of services change in the light of new social and economic research and social and economic circumstances change affecting the needs for services. Therefore steering takes place in practice on a continuous basis by contacts between ministries and agencies, even if these contacts are not formally recognised as a steering mechanism¹¹ (see Reform 12.1 on agency steering).

Continuous steering also recognises the fact that many services are aimed at helping households or businesses in difficulty. In those cases the broader policy target is often in preventing clients from getting in difficulty and needing the service to begin with. This suggests that successful policy implies reduction rather expansion of the service. This notion is captured by the expression “capacity budgeting”: budgeting for agencies should be based on sufficient capacity to provide the services if needed. Successful policy often means that the services are not needed (see Reform 12.2 on capacity budgeting).

The recognition of permanent steering has led in the UK, the Netherlands and Sweden to a split in the roles of financing and steering of executive policy on the part of ministries. As soon as this split is recognised, it can formally be attributed to two different units in the core ministry. The financing role is often fulfilled by the permanent secretary, supported by the financial directorate. The steering role is often attributed to the policy making directorate (the tax policy directorate for the tax service, the directorate for public safety for the police, etc.). Supervision of performance belongs to the steering role. It concerns a permanent process aimed at providing services of the required quality (see Reform 12.1). Financing is an annual process aimed at efficiency and minimisation of costs (see Reform 12.2).

b. Special facilities in operational management

The original idea of arm’s length agencies was that steering and control would be based on outputs and that, in return, government wide standards of operational management would be relaxed. In the beginning there have been many experiments with additional freedoms for agency managers, particularly in the areas of human resources, finance, accommodation and facilities. Agency managers were allowed to switch between outsourcing and in-house production (leading to more or less staff and more or less procurement); to create new jobs with new function descriptions; to increase variable pay; to design their own recruitment and assessment procedures; to switch between civil servant contracts and private labour contracts; to carry over financial reserves to the next budget year; to borrow with the Treasury for investments; to rent their own premises and to organise in house or procure their own facilities (reproduction, cleaning, catering, cars, maintenance, etc.).

In the UK and the Netherlands, these freedoms have gradually been reduced. For instance, in the Netherlands the only exemptions to government wide rules of cost control that are still in existence concern a small facility to create reserves by carryover of budgets and a facility to borrow from the Treasury. The reserve facility is limited by the rule that the accumulated reserve of the agency cannot exceed 5% of the average production costs over the last three years. The borrow facility is strictly limited to the purpose of investments and subject to approval by the ministry.

As it turns out the reserve and borrow facilities do not play a large role in practice. From the Dutch evaluation (Ministry of Finance of the Netherlands, 2011) it appears that only 6 out of 44 arm’s length agencies have on average an investment level of more than 10% of their annual benefits (measured over the period 2007-2010). Only 2 agencies have

depreciation costs exceeding 10% of their benefits. Both of these are shared service centres (see Reform 6.1 in Chapter 6), namely the State Building Service (which owns the State buildings and rents them out) and the State Real Estate and Development Agency (which owns and develops State land). Capital intensity of production is very low. Only 4 agencies have a capitalisation factor (total benefits divided by total capital) higher than 1 (all included in the 6 agencies with the largest investments). For the large majority of arm's length agencies the largest part of their costs consists of compensation of employees, rent and procurement of goods and services. As to the borrowing facility it turns out that 15 out of 44 agencies make annual use of the facility, the remainder do not use it at all or only incidentally. In spite of the rule that the borrowing facility can only be used for investments, it turns out that loans have sometimes been allowed for other purposes. This has not been well explained in the budget documentation. As to the reserve facility, it turns out that almost all agencies make use of it. The size of the reserves varies substantially between agencies. The reserves are reasonably stable in time which could indicate that the reserves are not used for investments but to save financial resources ("contingency reserves") and that the ministries pay too much for the services of the agencies.

In the light of these findings, the question can be posed whether the accrual administration, the borrow facility and the reserve facility are necessary for all agencies, and whether these facilities should not be limited to the few agencies with substantial investment needs and be abolished for all other agencies. This would lead to simplification of the financial administration and to substantial savings.

Conclusions

Considering experience and evaluations, several governments have wholly or partly taken distance from the original ideas that inspired the agency movement of the 1990s. They have come to the conclusion that the results oriented governance model for agencies does not work as it was conceived. The provider-purchaser model cannot be used to steer agencies, if output cannot be measured, if politicians continually change the requirements on outputs to be produced, and if there are no competitive markets to assess prices. Additional freedoms for agency managers have led to cost increases. Many agencies don't need an accrual administration, reserve facilities and borrowing facilities because their investments represent an insignificant part of their costs.

In spite of these experiences and evaluations, no country that has devolved policy execution to arm's length agencies has yet decided to move the agencies back into the ministries. In the UK, the Netherlands and Sweden, where policy execution has mostly been moved outside the ministries, there is broad agreement that devolution has been a sensible reform even apart from the results oriented governance model and the additional facilities for agency management. The basic reason for this agreement seems to be that policy execution is an essentially different task than policy development and requires different types of skills, in particular executive and entrepreneurial skills that are more comparable to the skills required for production organisations in the private sector. It is seen as sensible that within the public administration, there is a clear distinction between the core ministries which focus on policy development and the agencies which focus on execution. This distinction in particular has consequences for human resource policy.

Furthermore, even if the results oriented governance model and the special facilities are rolled back, there still remains the one special feature of agencies, namely that they have their own financial administration, be it on cash or accrual basis. There is broad

agreement in the countries that have devolved policy execution to the agencies, that this feature is valuable. It allows politicians and the public to gain insight in the costs of policy execution as a separate task of government and it allows them to assess the costs of execution for each separate policy. This is seen as valuable information to assess the costs of public policy. In this light the countries that have devolved policy execution, broadly remain satisfied with this reform. It is also the reason that the reform remains worthwhile and inspiring for countries that have not yet, or not yet fully implemented this reform.

Feasibility of the reform

Devolution of executive tasks to arm's length agencies can in principle be applied to all countries with a well-developed public administration, including all OECD countries. In countries where it has not fully been implemented thus far it can lead to better quality of policy execution and better insight in the costs of policy execution. This can in turn lead to better insight in the costs of public policies, which may in turn lead to beneficial effect on policy development.

Reform 4.2. Use of common process units

Characteristics of the reform

The reform consists of merging agencies and/or sharing parts of the policy execution process across government ministries and agencies. Such horizontal integration is possible for the ministries and/or agencies that share similar tasks, the same clients, the same processes, and/or the same geographical target area and resulting in the use of common process units or service delivery organisations. This reform seeks to deliver three key benefits:

- savings;
- an increase of the quality of services;
- greater attractiveness of the public sector as an employer.

The common process units are placed under one ministry that assumes the role of economic ownership and is responsible for operational management. These units are financed on the basis of fees or lump-sum contributions paid by the client ministries to the owning ministry.

Where did it occur?

In the recent past various countries included in the Value for Money study have made attempts to realise efficiency gains by horizontal integration of production processes. Two models of such amalgamation can be distinguished: the Australian and Danish models. The Australian model is aimed at merging service delivery organisations on the basis of client characteristics. The Netherlands followed this model in some of its recent reforms. The Danish model is aimed at “seamless” interaction with government by means of electronic portals.

Analysis

Australia

Horizontal integration in Australia is provided by the federal government's Centrelink agency. Centrelink centralises all central government social services and benefits, namely payment services for the Department of Human Services; the Department of Families, Housing, Community Services and Indigenous Affairs and 20 other agencies and departments. Centrelink has an integrated ICT database that contains all relevant information regarding citizen's payment needs. The payment services cover old-age and disability pensions, family support, unemployment benefits for young people, and study loans.

Established in 1997, Centrelink has a staff of 26 000, of which 3 000 provide support services, 3 000 provide common ICT processing services and 20 000 are involved in case handling either in the headquarters or in the 15 regional offices¹². The case handling staff is organised according to programmes. There are for instance 600 social workers for social assistance programmes. The programme staff has counterparts in the line departments that Centrelink serves.

Centrelink has been costly to set up in terms of investment in ICT and buildings. Given a number of ICT investments that were deemed necessary in the last ten years, it is currently difficult to assess the extent to which the horizontal integration has saved resources, but officials think that this is the case if compared to a baseline of the previous organisational set-up. In addition, there has been a marked improvement in the quality of government services delivered to citizens as a result of Centrelink. Recently, Centrelink has been merged with Medicare and the Child Support Programme. Australian officials consider that additional savings can be attained by a more intensive use of the Centrelink infrastructure.

Centrelink is funded by the Ministry of Finance. Financing is split between base financing and variable financing. Base financing covers mostly capital expenditure (ICT, physical assets). Variable financing covers mostly current expenditure (both current operational expenditure and programme expenditure) which is strongly dependent on activity assumptions. These assumptions are revised regularly.

The Netherlands

Examples of common process units in the Netherlands are NL Agency (for subsidy payments to the corporate sector) and the Tax service (that pays income supplements for the Ministry of Social Affairs and Employment). Dutch agencies (both arm's-length and independent) are owned (in an economic sense¹³) by a single ministry. However, some are co-financed by other ministries, either on a basis of lump sum contributions, or on the basis of agreed fees for services provided.

Recent reforms of shared process agencies in the Netherlands were inspired by the Australian model of wholesale merger of service delivery organisations. The Dutch government has recently embarked upon a number of new reforms partly based on ideas that were developed in the Spending Review on "Operational Management" (see Box 4.1 below). This study explored various options for co-operation and mergers between units. Under the proposed framework the responsibility for executive policy remains with the line ministry in charge of the programmes. In case of full mergers, the common process units would be placed under one ministry that would assume the role of economic

ownership and be responsible for operational management. Financing would take place on the basis of fees or lump sum contributions, to be paid by the client ministries (including the owning ministry).

Box 4.1. Horizontal integration in the Netherlands

The spending review “Operational management” has identified clusters of executive agencies and ministerial divisions characterised by similar executive processes or target groups of service users. The most concrete proposals include the horizontal integration of three clusters of executive organisations:

1. Agencies tasked with paying cash benefits to citizens (unemployment, old age pensions, disability benefits, housing contributions, health premium contributions, study grants);
2. Agencies tasked with *incasso* (cash collection) procedures (fines, taxes, study-loans, etc.);
3. Agencies tasked with paying subsidies to the business sector (agricultural, environmental, technological and EU subsidies).

According to the calculations made for the spending review, horizontal integration of these three clusters can lead to savings of around EUR 250 million in 2015 (taking into account necessary costs of ICT and other investments).

Source: Government of the Netherlands 2010

Denmark

In Denmark the emphasis has been on using ICT to make interaction with government “seamless”. There is a citizen portal being set up in order to enable a broad array of public sector organisations – central and local – to use a common interface with the citizens. A new initiative with a positive business case¹⁴ is Digital Mailbox, where each citizen has a digital mailbox for receiving government communications (accumulated savings potential of EUR 65 million in 2016). Horizontal integration is also pursued across government through enhanced ICT standard setting by the Ministry of Finance, which will allow easy communication between all government units (central and local).

The use of common e-government components across the public sector or within selected domains is of great utility, not only to ensure increased efficiency (in some cases also large savings potentials) but also to establish a more integrated public sector as perceived by the citizens and businesses.

Models of horizontal integration

Country experiences described in the previous sections show that the focus in the area of agencies amalgamation can be placed either on the development of a common service delivery organisation, like in Australia and the Netherlands, or on “seamless interaction” which leaves back office tasks where they are, but guarantees easy access and communication, as is the case in Denmark. Nevertheless, although the emphasis may differ, both components are necessary in a policy aimed at horizontal integration. For instance, Australia’s social service delivery organisation (merged Centrelink, Medicare, Child Support Programme) needs to communicate with the line ministries that are responsible for executive policy and the Danish Agency for Government Management

needs to establish shared front office units (the citizen portal, the Digital mailbox unit, etc.).

In any model of horizontal integration a solution has to be found for the ministerial responsibility for executive policy in the shared process units. In the Danish case the responsibility for common front offices rests with various line ministries and also with the municipal ATP organisation (“Labour markets Additional Pension), which implements a number of pension benefits on behalf of the municipalities. In Australia the responsibility for service delivery in the social area now rests with the Department for Human Services.

When designing horizontal integration, the best way to proceed may be to conduct a government wide study, in which all modalities for process sharing are thoroughly analysed. In the light of the Danish and Australian experiences the primary focus could be on similarity of services (for instance cash payments, cash collection, medical examinations, social consultancy for families) or similarities between client groups (for instance, students, elderly people, small and medium enterprises, etc.).

As to the steering of the shared process units, the following lessons can be drawn from international experiences:

- Make one line ministry (the “owner ministry”) responsible for funding and operational management of the common process agency or the merged agency.
- Make other client ministries negotiate their financial contributions and service delivery requirements with the owner ministry (not directly with the common process or merged agency) before, and if necessary after, the conclusion of the funding contract with the agency.
- Give a role to all client ministries in the permanent performance dialogue with the common process agency or the merged agency. The performance dialogue should be conducted in a co-ordinated way under the leadership of the owner ministry (not by each client ministry separately).

It is important that merging of agencies into common units should be complemented by the introduction and/or further development of online services to make government services more efficient and effective. These reforms are expected to lead to:

- a “tell us once” approach;
- a service delivery portal that guides citizens through interaction with government; and
- physical locations where citizens can access multiple services.

Feasibility of the reform

Costs, benefits and risks of horizontal integration should be well considered before implementing this reform in a country. The international experiences suggest, for example, that full mergers are not always necessary to realise the savings potential. To realise the sought benefits horizontal integration may only affect small front offices like in Denmark. Furthermore, it is not always obvious that merging all organisations with similar tasks or similar target groups will lead to an optimal size of production. In any case it is essential that every initiative in this area is based on a thorough business case analysis, which shows clear savings.

Reform 4.3. Role of independent agencies

Characteristics of the reform

This reform consists in protecting independent agencies from government interference in their executive policy, while maintaining government supervision on their operational costs and without excluding them from the standards of operational management that apply to (core) ministries and arm’s length agencies. This implies that they should not be granted a special legal status other than that of arm’s length agencies and that they should be given legal personality only under strict conditions.

In many OECD countries independent agencies (in the sense of the Value for Money study) constitute an important part of the central government sector, both in terms of employment and in terms of operational expenditures. Simultaneously, the regulation of these institutions is often complicated and fragmented, and in practice they often escape standards of operational management that apply to ministries and arm’s length agencies (see Chapter 6). This reform aims to eliminate the resulting inefficiency and waste.

Where did it occur?

The domain of independent agencies is an area of concern from the perspective of operational management in many OECD countries. However, the problem is approached differently in every country, due to the fact that the typology of publicly controlled organisations is different in every country. In Sweden, independent agencies are not recognised as a separate group of agencies with special legal status, next to arm’s length agencies. As a consequence standards of operational management that apply to arm’s length agencies, equally apply to independent agencies as defined in this study. This can be seen as best practice approach to cost control in independent agencies.

Analysis

Independent agencies and public non-profit institutions

The Value for Money Study distinguishes three types of organisations: core ministries, arm’s length agencies and independent agencies (see Glossary and Chapter 2 for the definitions).

The definition of an “independent agency” as used in this study is based on conceptual distinctions that may not be used or only partly be used in national typologies. These national typologies are widely different between countries, which complicates comparative analysis.

As far as independent agencies are concerned, the problem of international comparison is further complicated by the fact that some of these agencies have legal personality. They belong to the so-called public non-profit institutions. They are controlled by government but they are not part of the State. Since the 1990s of the last century the relevance of legal personality tends to be given less emphasis than was previously the case. This is true both for analytical studies in public administration and for practical policy documents that are produced by governments. This is probably due to the fact that the attribution of legal personality is often due to historical developments and *ad hoc* decisions. In many countries the resulting pattern is therefore arbitrary. Similar agencies may have, or lack legal personality without clear reason. However, regardless of legal personality, there is common concern in regard to independent agencies, which is

that operational costs have increased much faster than in core ministries and arm's length agencies.

Against this background, governments have taken new initiatives to improve control over the operational costs of independent agencies. In this respect three approaches can be distinguished, exemplified by (1) France and the Netherlands (2) the UK, and (3) Sweden.

Alternative approaches to cost control in independent agencies

A. The French/Dutch approach

In the context of the French spending review procedure¹⁵, initiated under the Sarkozy presidency, France has put up a list of all central government institutions outside the State, called “*Opérateurs d’Etat*” (State Operators). These institutions have legal personality and are thus, public non-profit institutions. Their legal status can vary: they can have several forms of public legal personality (“*Établissement Public Administratif*”, “*Établissement Public Industriel et Commercial*”, “*Groupement d’Interet Public*”) or of private legal personality (foundations, associations). In total some 650 institutions were identified. They can be divided in groups of institutions of the same kind, such as universities and cultural institutions (museums, theatres, etc.) and unique institutions.

As a first step, the French government has started to apply rules of operational management to all institutions on the list. Although the State operators have legal personality and thus own their own resources, they are dependent on public financing, so that rules of operational management can be imposed on them via conditionalities attached to the public grants. However, in France there also exists a large number of agencies that have no legal personality and still enjoy a large degree of autonomy in virtue of their legal status as “*Services à compétences nationales*” (SCN, Services with National Competences) and “*Autorités administratives indépendantes*” (AAI, Independent Administrative Authorities). These agencies thus far escaped the rules imposed on State operators. For this reason the French government has now embarked on a broader approach that covers not only the State Operators but also the SCN’s and the AAI’s. In the context of this broader approach the French word “*agences*” is now used to denote the entire spectre of independent agencies and public non-profit institutions. The basic idea is that all these institutions will be subjected to the same rules of operational management, which will be stricter than the regime previously applied to the State Operators. Moreover the new regime will require that core ministries develop a clear policy of operational management and financing (“*tutelle*”) for the institutions under their umbrella and become accountable for the results of this policy. Recent policy documents¹⁶ recognise that thus far there are no clear policies or criteria in place that determine which legal form publicly financed institutions should take (SCN, AAI or a variety of forms under public and private law with legal personality). This is seen as problematic and efforts are under way to develop a more systematic approach in this respect.

In the Netherlands, the Ministry of the Interior has put up a list of independent administrative¹⁷ agencies that are not subject to ministerial responsibility for their executive policies, called “*Zelfstandige Bestuursorganen*” (ZBO’s, Autonomous Organs of Administration). The list contains some 65 budget financed independent agencies¹⁸ and a few hundred others that are financed by their own revenues. Many of them have public legal personality, but some have not. A general law concerning these agencies requires

that they should be based on a legal statute (law or by-law), that contains provisions on the requirements of operational management that the government can impose on them¹⁹. In the past there have been efforts to develop criteria for the suitability of the status of ZBO. In 1994 a government committee formulated three criteria: (1) lack of discretion in policy execution in view of legal provisions, (2) participation of social partners or non-governmental organisations in their board of governance, and (3) protection against government interference in their executive policies. Since then several attempts have been made to narrow down these criteria (particularly to remove the first and second criterion) and to turn ZBO's into arm's length agencies, but these attempts have largely failed. The mentioned criteria are now enacted in the Law on the Autonomous Organs of Administration.

It is characteristic for the French and Dutch approaches that (1) they seek to apply the same regime of operational management to all public institutions that in virtue of legal provisions have a certain autonomy in their executive policy (“*agences*” in France, ZBO's in the Netherlands), and 2) they neglect the distinction between institutions with and without legal personality. This approach can largely be explained by the fact that in these countries there is no systematic pattern in the legal status of independent public institutions. There are no strict criteria for the attribution of legal status nor of legal personality and the current pattern is rather due to historical developments. Applying a uniform regime of operational management is then a more pragmatic solution than trying to change the legal status of existing institutions, for instance by depriving them from legal personality or bringing them under the regime that applies to ministries or arm's length agencies.

B. the UK approach

In the UK the development has been different. The British government started in the early nineties with an operation to devolve many executed tasks to agencies on arm's length distance from the government, the so called “next steps agencies” named after the Next Steps policy document of the Thatcher Cabinet (see Reform 4.1). This initiative provided inspiration to many governments of other OECD countries to start similar initiatives. The new agencies existed henceforth next to many other public bodies that had already a semi-autonomous status in virtue of legal and administrative provisions of earlier decades or even centuries

As a consequence the domain of public bodies grew substantially and it was not always clear which criteria were used for the attribution of the various forms of legal and administrative status.

The British government continues to work to provide greater clarity in the way in which it classifies arm's length and independent agencies. The Cabinet Office has published in 2011 a new guide for ministries on the categorisation of public bodies. This guide was revised in December 2012. Moreover, in 2010 the UK government undertook a review of public bodies, encompassing 900 public bodies across 17 ministries, which will lead to the abolition, merger, or substantial reform of approximately 500 bodies. Currently, the government distinguishes a range of categories of public body. Among these three key models are: 1) non-ministerial departments, 2) executive agencies, and 3) non-departmental public bodies (NDPBs).

Non-ministerial departments are departments (ministries) not headed by a minister but usually headed by a statutory board. They are accountable to Parliament through their sponsoring ministers, but have their own budget (estimate) voted directly by Parliament.

Examples are the Food Standards Agency, HM Revenues and Customs, Office for Standards in Education, Children's Services and Skills. They date from the time before the next steps initiative. In view of their privileged position it has become difficult to turn them into executive agencies.

Executive agencies are part of a Government department (ministry). They originated from the next steps initiative. They carry out a range of executive tasks, with policy (including executive policy) set out by ministers. They are part of a government ministry and have no separate legal personality. Examples are: HM Passport Office, Maritime and Coastguard Agency.

Non-departmental public bodies (NDPBs) comprise of four types:

1. Executive NDPBs: The Arts Council England, the British Council, the Information Commissioner, the Parole Board. Executive NDPB's are often established as statutory bodies or as companies.
2. Advisory NDPBs: Advisory Committee on the Misuse of Drugs, the Boundary Commissions (advising on Constituency Boundaries).
3. Tribunal NDPBs: The Foreign Compensation Commission and the Traffic Commissioners.
4. Independent monitoring boards are: The Independent Monitoring Board of Prisons, the Independent Monitoring Board of Immigration Removal Centres, and the Independent Monitoring Board of Immigration Holding Facilities.

Executive NDPB's are often established as statutory bodies or as companies (with legal personality) whereas the other types of NDPB's do not. NDPB's are usually financed by their parent ministry. It is government policy to reduce the size of the NDPB sector. All such bodies will be subjected to a review of control and governance arrangements every three years which will 1) provide a robust challenge to the continuing need for individual NDPB's, both their function and form, 2) if it is decided that a body should be retained as a NDPB, ensure that the body is complying with recognised principles of good corporate governance.

In making the case for a new NDPB, departments must assess the function or activity against the following tests: (a) is this a technical function (which needs external expertise to deliver); (b) is this a function which needs to be, and be seen to be, delivered with absolute political impartiality (such as certain regulatory functions); (c) or is this a function which needs to be delivered independently of ministers to establish facts and/or figures with integrity and credibility.

It is characteristic for the UK approach (1) that agencies that in virtue of legal provisions have a certain autonomy in their executive policy (NDPB's and non-ministerial departments, which are independent agencies in the terminology of this study) are fully accountable for their costs to ministers, regardless whether they have legal personality, (2) that strict criteria are used for the establishment of the various types of arms' length and independent agencies and that efforts are made to change the administrative or legal status of existing bodies in line with these criteria.

C. The Swedish approach

In Sweden the pattern of agencies with a certain kind of autonomy in executive policy is quite systematic. There are some 370 agencies in Sweden. They don't have legal

personality and are all part of the State. All of them are accountable for their executive policies to the government, but all of them are autonomous in their handling of individual cases. This autonomy is based on a centuries old tradition that aimed to protect the rule of law and to restrict the authority of the King to the domain of policy making. Accordingly the autonomy of the agencies in handling of individual cases is vested in the constitution and seen as a basic feature of Swedish public law. Public non-profit institutions (with legal personality) exist in Sweden only in the area of service delivery in kind (universities, research establishments, etc.), not in the area of administration.

It is characteristic for the Swedish approach: (1) that all agencies have the same status of arm's length agencies and are subject to the same standards of operational management; (2) that public non-profit institutions (institutions with legal personality) only exist in the area of service delivery in kind (universities, etc., not in the area of administration).

Which administrative agencies need to be protected against government instructions or guidelines about executive policies?

The Swedish approach can be seen as best practice from the point of view of operational management, but the question remains which administrative agencies (agencies tasked with administration rather than with in-kind service delivery) need special protection against government interference in their executive policies. In the context of the current study the Swedish authorities have only identified some regulatory authorities as in need of protection in special provisions of their founding laws, but they have also indicated that only a thorough investigation of all 370 agencies, including their founding laws, could reveal which other agencies should be protected in some way against certain forms of government instructions or guidelines.

There are few countries that thus far have developed strict criteria for the need to protect administrative agencies against government interference. However, the UK has done so: agencies can qualify as NDPB, in view of the role independent expertise, political impartiality or independent fact finding in their task performance. Based on information from other countries participating in this study, the British criteria are used in many countries, although sometimes alongside other criteria and sometimes in less strict formulation. In this light, it is possible to put up a tentative list of agencies that may need special protection and thus could qualify as independent agencies in the sense of this study.

The list could include the following three types of administrative agencies:

- forecasting agencies and the statistical bureau (see Reform 3.4);
- regulatory and supervisory agencies²⁰ (see Reform 5.1);
- the advisory bodies and their secretariat.

If countries aspire to bring a more systematic approach to the attribution of legal status and legal personality in the organisation of central government, this list could be a sensible point of departure.

Which agencies need legal personality?

In France and the Netherlands independent agencies (“Agences”, “ZBO’s”) may have legal personality or not and no strict criteria are applied in this respect. In the UK,

executive NDPB's are often set up as statutory bodies or companies (with legal personality), whereas other types, for example advisory NDPB's, are not. In Sweden no agency has legal personality separate from the State.

Legal personality provides a certain protection to own revenues of executive agencies. These revenues are not supervised by government and not authorised by Parliament. Furthermore they are automatically earmarked for the expenditures of the agencies (unlike the revenues of budgetary and extra-budgetary funds that need special legal provisions to have their revenues earmarked for the fund's expenditures). The question arises why independent agencies would need legal personality (and thus become public non-profit institutions).

In order to answer this question, it should first be noted that independence, in the sense of protection against government intervention in executive policy, is not dependent on legal personality. A government agency can be protected against government intervention regardless whether it has legal personality. From this perspective it would be appropriate to conclude that independent agencies do not require legal personality at all.

From the perspective of operational management, legal personality may pose an obstacle: organisations with legal personality do not belong to the State as a legal entity. They own their own resources in the legal sense. As a consequence the state budget authorises the public funding for these organisation as net expenditures (net of expenditures financed from own revenues), whereas the budget authorises the expenditures of agencies belonging to the state as gross expenditures and the non-tax revenues earmarked for these expenditures as state revenues. This has consequences for the applicability of standards of operational management. The government can impose standards upon its own agencies by way of internal regulation. Institutions with legal personality cannot be ruled by internal regulations. If the government wants to impose such rules on legal persons outside the State, also in so far as their expenditures are financed by own resources or own revenues, it can do so only in the form of conditionalities attached to public funding.

However, attribution of legal personality can have its own rationale, namely that it provides an incentive for collection of own revenues and hence for efficiency (an agency will care more for efficiency if it concerns services that are partly financed from own revenues). In this light the stated question can also be answered from the perspective of whether it may be sensible that this incentive is introduced for certain independent agencies. The answer now depends on the type of independent agency. Supposed that in a country strict criteria for independence are applied, so that only the three above mentioned types of agencies enjoy legal protection against government intervention in executive policy, then a case could be made that the first type of agency (forecasting agencies and the statistical bureau) should have legal personality. This will stimulate these agencies to provide forecasts and statistics to private sector institutions, next to their public tasks. This may contribute to their efficient task performance. It is hard to see how this argument can be applied to regulatory and supervisory authorities and to advisory bodies and their secretariat. These agencies can do without legal personality as is the case in the UK and Sweden. These countries can be seen as best practice in this respect.

Note finally, that the mentioned rationale for legal personality may apply to public institutions tasked with service delivery in kind. In many countries, including France and the UK, providers of individual services in the sphere of health care, long term care, education, social and cultural services are organised on a large scale as public not profit

institutions. Under certain conditions attribution of legal personality to these institutions can be consistent with the mentioned rationale (see Reform 4.4).

Feasibility of the reform

The domain of independent public institutions is a particularly complicated and fragmented area of central government organisation in many OECD countries. In many countries, legal status and legal personality is attributed in an unsystematic way based on historic developments. In addition, and partly as a consequence, there are few internationally comparable features or trends.

What is comparable, however, is that the domain is in need of reform in many countries. This need arises in the first and foremost case from the deficiencies in operational management arising from the unsystematic attribution of legal status and legal personality. As a consequence many independent agencies escape the rules of operational management that are applicable to core ministries and arm's length agencies. The required reform has to tackle first the criteria for the attribution of legal status and legal personality and second the nature of the independent agencies that need some form of protection against interference in their executive policies. Experience in several countries show that the first part of the reform is a particularly difficult and politically sensitive exercise. It requires a strong political commitment and a thorough preparation. In various countries efforts are under way to embark on this reform, not surprisingly in cases where the current situation raises the most concern (including France). However, the reform should also be inspiring in many other countries where further improvement is possible and can lead to substantial savings.

Reform 4.4. Role of private non-profit institutions in service delivery

Characteristics of the reform

The reform devolves publicly financed service delivery in the area of individual services (education, health care, long term care, social services), to the private non-profit sector (sometimes called the voluntary sector). The aim of the reform is to promote competition in service delivery leading to better quality and lower costs.

Where did it occur?

Many OECD countries currently seek to increase the role of the private non-profit sector in the delivery of publicly financed services. The country that has traditionally used the private non-profit sector to the largest extent to produce publicly financed services is the Netherlands. Health care, long term care, social and cultural services are entirely provided by the private sector in the Netherlands (around 15% of GDP). Primary and secondary education are provided for two thirds by non-profit institutions with private legal personality (foundations, associations), but in view of government control and funding, these institutions are seen as public non-profit institutions (in the general government sector in the national accounts). The UK has also a clear policy in place for the devolution of publicly financed service delivery to the private sector, particularly in the areas of education, long term care and social and cultural services (health care remains largely in the general government in the UK). In the UK the private non-profit sector provides for a growing, but still relatively small, share of total publicly financed individual service delivery, but this amounts to about half of total expenditure of the private non-profit sector.

Analysis

Provision of individual services in kind

As noted in the introduction to this chapter policy execution mainly includes three tasks: (1) application of administrative law in individual cases, leading to administrative decrees (licences, permits, concessions, admissions, etc.), (2) application of financial regulations in individual cases, leading to tax assessments and public commitments (subsidies, grants, social benefits, etc.) and (3) provision of collective and individual services in kind. The execution of all three tasks requires the use of support services, finance, human resources, procurement, etc. The third task is different from the first and second in that the supply chain can entirely be outsourced (privatisation). As to the first and second tasks, the government must remain responsible for administrative decrees and financial assessments and commitments. In the case of service provision in kind the government must only remain responsible for appropriate provision, which in principle can be realised through quality control and accessibility requirements, usually involving financing. Furthermore the provision of individual services is a typical development of the last century. In the era before the “welfare state” production of individual services was typically left to the market, including the voluntary sector (private non-profit institutions).

The main policy instruments that have been used to further the aims of the welfare state are twofold: 1) financial regulations establishing public financial commitments in the form of social benefits (unemployment, sickness, family benefits, disability and old age pensions), and 2) provision of individual services in kind, that are seen as basic needs (education, health care, long term care, social services).

As it turns out, OECD countries have organised the provision of individual services in different ways. Since these services can in principle be provided by the market (and were provided by the market before the welfare state), the relation to market provision is the key policy variable in this respect. Some countries have virtually taken over the provision of these services from the market, providing them free of charge through public agencies (France is the typical example). Other countries have tried to leave market provision as much as possible intact, but have strongly regulated the market to ensure accessibility and quality, usually involving a high level of public financing (the Netherlands is the typical example). Most countries have followed an intermediate course by organising public provision, while simultaneously strongly regulating private provision, thus creating alternative arrangements of supply. Furthermore the picture is typically different for separate basic services: education may be partly private, while health care is mostly public, like in the UK, or health care may be mostly private, while education is mostly public, like in the USA.

In many countries there are debates about the appropriate roles of public and private modes of provision. These debates take place against the background of national circumstances and traditions and often have a highly political character (in that different political parties have different views). Furthermore these debates often have a rather technical character in view of the complicated policy arrangements that have developed over the past decades for each of the individual services involved in each separate country. It is not possible in the context of the present study to identify any best practices in this respect for any of the services concerned. However, it is possible to identify a certain general trend in a number of countries over the last few years to put more emphasis on individual service provision by private non-profit institutions. This trend can

partly be explained by the global financial crisis which in many countries has led to more scrutiny on the tasks of government. The UK is a good example in this respect. The Netherlands is mainly interesting because it traditionally belonged to the countries with a large role for private non-profit institutions in the provision of publicly financed services and still stands out in this respect among all other OECD countries.

Public and private non-profit institutions

Both public and private non-profit institutions have legal personality. In spite of the absence of a profit motive, this creates a certain incentive for efficiency (see Reform 4.3). However, public non-profit institutions are per definition controlled by government (in the sense that their executive policies are decided by government and their board of governance is appointed by government). If this condition is not met a non-profit institution is considered as private. A private non-profit institution can then still be financed mostly by government in the form of fees for services, but it is then seen as a market producer and belongs to the corporate sector in the sense of the national accounts. A public non-profit institution (controlled by government) that is mostly financed by the proceeds of its sales is equally seen as a market producer and part of the corporate sector (as a state owned enterprise, SOE, or local government owned enterprise).

Although both public and private non-profit institutions are subject to certain efficiency incentives in virtue of legal personality, the incentive is usually much stronger in private institutions, due to competition. In the case of publicly financed services in kind, competition mostly focuses on quality not on prices. Efficiency of the production process is enhanced because gains can be used to increase quality. There is little room for price competition, because prices are usually strictly regulated to ensure accessibility. However, in the case of private producers, additional quality or services above prescribed minimum levels can sometimes be purchased at market prices. In that case competition can also affect the prices for these mark-up services.

Financing of basic individual services

If individual services in kind are provided through private non-profit institutions, public financing has to take place through fees and subsidies. This can be realised in two ways: through vouchers that are provided directly to the consumers, or through financing of admitted institutions. If vouchers can only be spent on services of admitted institutions both financing modes are equivalent. In practice however, vouchers usually offer a larger choice to consumers. For instance, in long term care, they can often be spent on aid at home or facilities in the home. Both voucher financing and direct financing make it possible to ensure quality control through admission requirements on supply institutions.

Publicly financed services in kind need not be provided free of charge (implying that public contributions cover cost prices). In most cases regulations prescribe uniform low prices. These prices serve two purposes: they contribute to financing and they serve as “brake payments”, meaning that they prevent unnecessary use of the services. However, since they are prescribed and uniform, they do not contribute to competition and efficiency. Furthermore, prices have a different role in production by non-profit producers than by for-profit producers. Since non-profit institutions cannot easily raise capital, they are largely dependent on internal financing for expansion. Paradoxically, this often implies that they make more profit than for-profit institutions in order to make this possible²¹. In principle private for-profit producers offer better efficiency incentives than private non-profit institutions, but governments and the public are understandably

cautious with allowing profit making in the provision of basic publicly financed services. Only in the areas of housing and transport, where subsidies typically amount to less than half of the cost, are for profit institutions commonly allowed to provide services.

In many OECD countries there is a debate on the question whether individual services that are considered as basic needs should be provided at low uniform prices also for those who can afford to pay market prices. This debate has sometimes led to the conclusion that certain publicly financed services should only be accessible for households with low incomes, or that regulated prices are increased for households with larger incomes. Such measures are understandable in times of austerity in public finance but they have important drawbacks. Prescribed private contributions to publicly financed private services must be seen as taxes, since the consumption of these services is legally or factually unavoidable. This means that income dependent private contributions add to the marginal tax rate for low income households, which is even more problematic from a microeconomic point of view than an increase in the marginal tax rate for high income households. In addition income dependent private contributions are hard to execute and prone to irregularities and fraud. In this light income dependent private contributions should only be considered by countries with a highly developed system of household income administration and preferably be executed by the tax service.

Some special cases

Public transport

In most OECD countries, public transport companies are public for-profit institutions (public enterprises, owned by the State or local government), which are heavily subsidised, but mostly not more than 50%, so that they belong to the corporate sector (in the sense of the national accounts). Sometimes the infrastructure (mostly railways) is split off in a separate company that is equally a public for-profit institution and heavily subsidised.

Although in general public transport is only partly financed by government, the argument that it concerns a basic need (welfare state service) still plays an important role in the discussion about financing in many countries. Another argument in favour of subsidising is alleged positive external effects. Neither argument is very strong. Public transport has only beneficial effects on others than consumers if it diminishes private transport. However, many empirical studies show that the cross-elasticity tends to be low. But even if a weak effect on private transport can be proven, this does not amount to a positive external effect, but rather to a reduction of the negative effects of private transport. These negative effects have to be reduced by better pricing of private transport or by green taxes, not by subsidising public transport. As to the argument that transport is a basic need, it can indeed be observed that some forms of transport (trains and buses in remote areas, trams and buses in urban areas outside rush hours) cannot be exploited on a commercial basis, because it would lead to prohibitive prices. If this would lead to abolition of these forms of public transport, some low income households would suffer from reduced mobility. However, other forms of transport tend to be highly profitable due to monopolistic market conditions. In general, public transport companies can be required to cross-subsidise their unprofitable activities with the profits from their lucrative activities. Only if this is impossible (for instance if a company hardly conducts lucrative activities) can subsidising on the basis of the basic need argument be considered.

Public housing

In most OECD countries housing is seen as a basic need and thus in principle a concern of government. However, for most households the market can provide for their needs and government intervention is not necessary. Government intervention tends to focus on low income households or households with special needs. This tends to take two forms: rent subsidies for eligible households and public supply of low rent houses. Public suppliers can be for-profit (public enterprises) or non-profit institutions. They can be owned by the State or by local government. In the case of public ownership, rent subsidies are usually hidden in the form of public financing of the suppliers.

The case for public ownership is weak. It tends to distort the housing market. Private for-profit companies are discouraged to invest in low-rent housing investment and public suppliers do not invest enough due to lack of capital (public non-profits) or lack of competitive pressure (public for-profits as well as non-profits). This leads to supply shortages, waiting lists, and wrong allocation (middle income households in low rent houses, who stay there in view of rent protection). This is a major problem in many OECD countries.

Rent subsidy for eligible households is a better instrument to meet the basic need for housing. Privatisation of supply would lead to savings (not all households renting from public suppliers would be eligible for subsidy), would invigorate the market for low rent households by attracting investment by for-profit suppliers, and would in the long run lead to additional savings when sufficient low rent houses have become available.

Feasibility of the reform

Reforms of this type are usually complicated. They need to be tailored to the specific features of the existing national policy arrangement of each area of service delivery. Usually they are also politically controversial. It would be premature to conclude that there exists any best practice in this respect in any of the policy areas concerned. Nevertheless in a number of countries that are on the forefront of innovation in this respect, a tendency can be observed in the direction of devolution of delivery of basic individual services to the private sector.

Accessibility and quality can in principle be assured by regulation, possibly complemented by the establishment of supervisory agencies (see Reform 5.1 on social supervisory authorities). The reform leads to increased competition and thus to better quality and more efficiency. In the long term the savings can be substantial. Reforms of this type can also reduce the size of the government in the national economy by a substantial percentage (10 to 20 percentage points). The reform applies to individual services in kind that are mostly financed by government (education, health care, long term care, social services) and also to some individual services in kind that are mostly provided by the market, but where public subsidies can be motivated with the “basic need” argument (public transport, public housing).

Reform 4.5. Reform of the foreign service

Characteristics of the reform

The reform consists in increasing efficiency of the Foreign Service by focusing on its core tasks and political priorities as defined by the foreign policy of the country, by using technology more effectively and by adapting organisational arrangements to the changing

needs (smaller and more efficient networks). Among other things the reform includes the devolution of individual service delivery in the sphere of trade promotion to other agencies and to the market.

Where did it occur?

The Foreign Service is one of the most labour intensive areas of government services; therefore many countries focus its attention on modernising and making possible savings in this area. The UK, Sweden, Norway and the Netherlands are among the countries that have modernised and continue to reform their Foreign Service.

Analysis

Background information

The core tasks of the Foreign Service remains relatively unchanged over time while political priorities can change depending on the shifts in the Government and in the country's policy agenda. A modern Foreign Service adapts its personnel and organisational structure to the political priorities and changing needs swiftly, reallocates limited resources rationally, and strikes an optimal balance between the costs and quality of services.

The reform supports the following initiatives to increase efficiency and reduce the costs of the Foreign Service:

- Consolidating finance, HR and purchasing functions (support services) into country or regional hubs and sharing office space with other countries' missions when possible leading to savings in office and residential accommodation and support services.
- Calibrating trade promotion tasks of the Foreign Service network, delegating greater responsibilities to private institutions (the chambers of commerce, to businesses) and drawing a clear line between the tasks of the Foreign Service and of sectoral ministries.
- Developing specialisation within the Foreign Service network coupled with shrinking the personnel and engaging attachés from line ministries.
- Granting the European External Action Service (EEAS) of the EU the power to provide consular services on behalf of EU countries.

In this study no attempt is made to compare foreign services in quantitative terms. There is no common ground for comparison. For instance, some countries have privatised trade promotion (Switzerland) or put it on the budget of other ministries (Nordics, partly Netherlands). Some countries organise culture promotion in separate institutes (France, Spain, UK), others have it done by the Foreign Service, etc. Solving these problems of comparison should in principle be possible but could not be undertaken in the context of the present study. Nevertheless, the impression exists that there are large differences between countries, even if such factors are taken into account.

The United Kingdom

Apart from the consular services, the core tasks and priorities of the Foreign Service differ from country to country. For example, in the UK foreign policy focuses on the following areas:

- safeguarding national security by countering terrorism and weapons proliferation, and working to reduce conflict;
- building Britain's prosperity by increasing exports and investment, opening markets, ensuring access to resources, and promoting sustainable global growth.

In the UK the global network of the Foreign and Commonwealth Office (FCO) extends to 141 sovereign and 130 subordinate posts in 160 countries. The FCO employs around 14 000 staff around the world. Roughly one-third are UK-based British Civil Servants whose career typically includes work in the UK and postings overseas; and around two-thirds are locally engaged staff, employed by a British Diplomatic Post overseas (such as an Embassy, High Commission, or Consulate).

The FCO has set a target of GBP100m savings by 2014 - 2015 in support services, including human resources and estate of which GBP 25 million savings have been achieved by 2012 (UK Government, 2012). The FCO intends to reduce the costs of office and residential accommodation and corporate services by consolidating finance, HR and purchasing functions into country or regional hubs. The FCO has also focused on building a new global network for data services, telephony and unclassified videoconferencing joining up overseas posts and the FCO in London. Savings of 30-40% of existing costs are expected to be produced by improving business functionality and replacing the global desktop service. For instance, the FCO plans to rationalise and improve high classification systems and introduce new mobile telephony and laptops to work smarter and share knowledge and information more effectively.

With the aim to produce efficiency savings, the FCO builds real and virtual knowledge networks across Government and with academic organisations to share best practice and expertise. It also develops the FCO's electronic records system and the FCO-wide electronic library to broaden access to the FCO's archive.

The FCO increasingly uses digital networks to communicate policy messages²². For instance, a virtual Embassy in Iran has been established²³. Its Ambassadors are using blogs and social media, to great effect, to communicate directly with citizens in their countries, providing a reach of millions.

Sweden

The core tasks of Sweden's foreign policy are:

- representing the Swedish government in foreign countries and safeguarding national security;
- promoting trade (facilitating exports and imports to and from other countries; creating favourable conditions for Swedish interests and raising Sweden's profile);
- promoting and enhancing respect for human rights.
- international development co-operation;
- providing advice, help and protection to Swedish citizens abroad.

The Swedish Foreign Service comprises of the Ministry for Foreign Affairs and the 103 missions abroad, which include embassies (89), representations/delegations (7) and consulates (7). There are also 10 roving ambassadors based in Stockholm for specific countries. Premises are in a few countries shared with the missions of other countries. The staff of the Ministry for Foreign Affairs in Stockholm is 750 persons and another 530 Ministry for Foreign Affairs officials, together with around 1 300 locally employed persons, serve at missions abroad. In total there are 2 580 persons working in the Foreign Service as a whole²⁴.

Modernisation of the Swedish Foreign Service is an on-going process in order to realise an effective use of given resources and adapt the activities and organisation to changes in the world. Modernisation efforts include digital diplomacy (including placing all embassies on Twitter and Facebook). Decisions have been made to establish a few embassies with only one diplomat. In these cases administrative matters will be handled in Stockholm or by a near-by mission. This kind of concentration in hub-missions will be considered also for other small missions. Increased outsourcing of immigration matters is another example that will affect the workload of several missions.

Norway

The main tasks and functions of the Foreign Service Missions of Norway (as described in the Norwegian Foreign Service Instructions of 2003) are:

- Representing the King and the Government;
- Safeguarding and promoting Norway's interests in the relations with other countries;
- Acting as the Government's spokesman to the Government of the receiving State, international organisations and local authorities;
- Keeping the Government informed on current developments in the receiving State;
- Public diplomacy, cultural exchange and promoting Norwegian business interests;
- Providing advice, help and protection to Norwegian citizens abroad.

As of 2011, there are 2 483 people working for the Foreign Service in Norway of which 830 are in Oslo, 662 are posted abroad, including special representatives from other ministries and 991 local employees at missions. There are 106 Norwegian missions abroad (85 embassies, 10 consulates general, 7 permanent delegations, 3 embassy sections, 1 representative office) and 380 honorary consulates²⁵.

The efforts in modernising the Foreign Service in Norway were spurred by a slowdown in the budgetary growth. Norway focused on effective use of resources by clear prioritisation, rational division of labour throughout the network, flexibility in the reallocation of resources following the changes in political priorities, and close co-operation with subordinate agencies and other parts of the administration. The Strategy 2013 adopted by the Ministry of Foreign Affairs includes such initiatives as introducing a performance management system for the Foreign Service to ensure the best possible match between priorities and available resources; planning for fewer but more robust missions that can act as hubs, and cover more regional and thematic tasks; improving co-ordination of efforts across thematic, departmental and national borders; and outsourcing tasks in certain areas, such as administration, ICT and immigration.

The Netherlands

The Dutch foreign policy is focused on:

- international stability and security, energy and raw material security;
- international legal order (including human rights);
- commercial and economic interests of the Netherlands and Dutch businesses.

The Foreign Service network in the Netherlands includes 112 embassies, 23 consulates-general, 18 representations with public international organisations and representation with Palestinian Authority in Ramallah and 316 honorary consulates. As from 2013, there are 8 regional support service centres.

Dutch diplomacy is undergoing reforms. The reform programme promotes clear choices and new priorities and emphasises economic diplomacy²⁶. The Ministry of Foreign Affairs will cut EUR74 million by 2015: 55 million at embassies and consulates and 19 million at the Ministry in The Hague. The network should become cheaper, more efficient and better equipped. Savings are to be made on terms of employment and accommodation. The closure of missions is subject to the approval of the Council of Ministers. An extra saving of EUR8 million per year will allow investment in areas like economic diplomacy and consular assistance to Dutch nationals abroad. The workforce is to shrink from 2 800 at present to 2 500 in 2015²⁷. It is planned to cut 200 positions in the embassies and consulates and 100 positions in the Ministry in The Hague. The current number of 356 attachés is also to be cut substantially.

Moving away from the traditional image of an embassy as a building with a flag and mission staff is another underlying idea of the reform. The concept of travelling ambassadors, based in the Hague is being developed. There will be more regional embassies representing the Netherlands in more than one country.

Consular services are also set to slim down and to become more streamlined and reliable. One of the negative consequences of a smaller Dutch mission network would be a higher cost of passport application for Dutch nationals abroad because travelling costs may increase. However, to compensate for this inconvenience, the validity of passports will be extended to ten years.

Structural cuts are also envisaged to the budget for development co-operation. For instance, the reduction of the development budget from 2010 to 2012 is 0.1 percentage point of GDP (from 0.8% of GNP to 0.7% of GNP).

Concentration on core tasks

The underlying idea of the reform is to focus on the core tasks and political priorities of the country's Foreign Service that has four main consequences:

1. Consolidating support services in the country or regional hubs and sharing accommodation with other countries' missions.

Support services (in the sense of the Value for Money study) should be taken out of the embassies and put in the capital, or in so far as proximity has any added value, in regional shared service centres. Finance, human resources, accommodation and procurement tasks of representations can be well concentrated in the capital or in regional hubs and thus provide for savings in office and residential accommodation and corporate services. New technology can help realising this transfer, working smarter and

sharing knowledge, information and data more effectively. Building up a global network for administrative services (telephony, teleconferencing, shared electronic databases) can bring efficiency gains joining up overseas posts and the Foreign Ministries in the countries.

Another important element of the reform is to continue to modernise the way the countries procure and manage the global estate, driving down costs wherever possible, and allowing the Foreign Service to concentrate on the front-line tasks. For instance, the savings in office and residential accommodation and support services could be produced if premises are shared with the missions of other countries.

2. Focusing the tasks of the Foreign Service and separating them from the tasks of the private sector and of the Ministry of Economic Affairs (or other sectoral ministries) in the area of trade promotion.

There is an increased attention in several countries for economic diplomacy and creating opportunities for economic growth and expanding overseas markets. However, this does not need to translate into personnel expansion within the Foreign Service, but it should result in focusing on the core tasks of the Foreign Service in the trade promotion area and in quicker reactions to unfolding international developments in economic and trade affairs. It implies a clear separation line between the Foreign Service tasks and the tasks that can be privatised or financed by the Ministry of Economic Development or other relevant sectoral ministry.

The tasks of a Foreign Service trade diplomat should involve establishing and maintaining contacts with governments, public administrations and international organisations. Other tasks, such as contacts with businesses, market scans, and participation in business fairs can be ensured by private units, such as Chambers of Commerce or business representations or by the Ministry of Economic Affairs. In the latter case the attachés from the Ministry of Economy or other relevant line ministries can be allocated to the overseas representations and be financed by the ministries concerned. Such practice already exist in several countries and should be further developed (for instance in the Dutch Foreign Service network there are 23 posts for the support of the business sector belonging to the Ministry of Economic Affairs).

3. Specialisation of missions and engaging representatives of sectoral ministries

Developing specialised embassies (or other network missions) means having the right workforce with the right skills in the right place. Specialisation of embassies leads to cutbacks in posts of embassies (large and medium-sized) that are not crucial for the core tasks of the foreign policy. If certain embassies or posts are particularly important for certain line ministries but not covered by the core tasks of the foreign policy, these line ministries can send out personnel to those embassies. These employees are not part of the Foreign Service and their appointment can be temporary in the light of concrete needs or projects.

In general, reduction of foreign services personnel in large and medium-sized embassies is a less drastic way of consolidation than wholesome closing down of embassies and it has less adverse effects on bilateral relations and service delivery to citizens. In regions where there are only few embassies, regional desks (one embassy for a region of several countries) and “lap-top” diplomats are a way to retain contacts and information in the capital. Under this framework, development assistance is also

separated from the Foreign Service and insured by people attached to respective ministry and insured by a respective budget.

4. Granting the European Foreign Service with the power to provide consulate services on behalf of EU Member State

The European External Action Service (EEAS), otherwise known as the “European foreign service”, has now existed for two years. It has staff of 3 500 (1 500 in headquarters and 2 000 in 140 EU delegations)²⁸ drawn from the EU institutions and national diplomatic offices. The role of the EU delegations consists of co-ordinating the work of national embassies, representing the EU and its policies; and engaging in political reporting. However, the EU delegations do not currently offer real consular services. Granting the extensive network of EU delegations with the power to deal with consular issues (issuing passports, visas and provide other forms of consular support) would be very beneficial for national Foreign Services and for EU citizens in general.

As there might be sensitive issues, the delegation of consular powers to the EEAS can be done to a certain extent through case-by-case agreements. For instance, the UK government could allow the EU delegation in Russia to distribute passport application forms and to collect them once filled in for UK citizens and send these to London (possibly by electronic means) for processing. As long as EU citizenship and immigration policies are not fully harmonized, EEAS officials can apply country specific procedures.

Feasibility of the reform

As the priorities of foreign policy differ from country to country, the reform design and implementation would be country- specific and depend on the needs and capacities. The reform framework can include all the elements suggested in the previous section for modernising the Foreign Service with the exception of the EU shared consulate (Element 4) for non EU countries.

Notes

1. Sometimes providing information is mentioned as a fourth instrument. In this study providing information is seen as a support service (communication, see Chapter 6).
2. Setting and collecting of fees for services in kind are seen as part of service provision in kind. Borrowing and collecting property income from privatisation or sale of government assets is seen as a support service (finance).
3. Remember that employment can also be divided in administrative employment and service delivery in kind employment (see Chapter 2). Administrative employment is all employment for policy development, administrative regulation and supervision, support services and the administrative part of policy execution. Service delivery employment is employment for provision of individual and collective goods in kind.
4. Since these distinctions apply to the central government sector (as part of the general government sector) they exclude State owned enterprises (which are in the corporate sector but belong to the “public sector” of state controlled organisations).
5. The term “State” is used here in the sense of the legal person of the central government. In federal governments sometimes the word “State” is used for the constituent bodies of the federation (for instance in the USA). This is a different meaning of the term that is not used here.
6. The public prosecutors are here not included in the Judicial Branch although in some countries they have semi-judicial status as the “standing branch” of the judiciary. They are considered here as independent State agencies.
7. In Sweden only 5% of central government administrative employment is left in the core ministries.
8. There is an academic literature (for instance Talbot and Johnson, 2007; Pollit, 2007) which has interpreted the developments in the last decade as a swing back from the arm’s length agency model. It is true that some concern has been raised in reports of the 2000s about a “silo mentality” and the need for “joined up” government (UK Government, 2002; James, 2003; James, 2004). However, this has not led to a roll back of the agency model, but rather to a clearer advisory role of agencies in policy development and in some cases mergers of agencies with adjacent responsibilities or reintegration with ministries (Elston, 2011). Simultaneously during the 2000s more than 50 new agencies were created (sometimes resulting from mergers) and the share of home civil service employment in arm’s length agencies continued to rise.
9. See Reform 12.1 for steering of agencies.
10. Benefits include contributions of the parent ministry and can thus be seen as an indicator comparable to total expenditures of an agency run on cash basis.

11. A good illustration of the fact that agreements about targets and budgets are usually not the real steering mechanism, is that for many agencies an arrangement exist, which specifies that budgets for services that have not been produced, must be returned (so-called after calculation).
12. In 2011.
13. In a legal sense all agencies without legal personality are owned by the State. Economic ownership means ultimate control over operations as guaranteed by standard setting for operational management. This competency remains with government, also in the case of independent agencies with legal personality.
14. A strict condition for the development of e-government initiatives in Denmark is the proof of cost savings in the form of a positive business case (see Reform 9.3).
15. “Révision Générale des Politiques Publics” (RGPP, General review of public policies).
16. See for instance République Française (2012), “L’État et ses agences” (2012) and Conseil d’État “Les agences : une nouvelle gestion publique ?”.
17. This inventory concerns only independent agencies with administrative tasks, not agencies tasked with service delivery in kind.
18. The list is not comparable with the French list of “*Opérateurs d’État*” because the latter contains agencies tasked with service delivery in kind and does only contain agencies with legal personality.
19. Law on the Autonomous Organs of Administration 2007.
20. Including the agency that supervises elections.
21. The literature on commercial non-profit institutions also suggests that profits are used for perks for board members and personnel (supported by many empirical studies).
22. See more on Digital Diplomacy in the UK at <http://blogs.fco.gov.uk/digitaldiplomacy/social-media-policy/>
23. See <http://ukforiranians.fco.gov.uk/en/>
24. The official web-site of the Ministry for Foreign Affairs, <http://www.government.se/sb/d/3367>
25. Information provided by the Norwegian Ministry for Foreign Affairs.
26. See more on the official website of the Dutch Ministry of Foreign Affairs www.government.nl/ministries/bz/about-the-ministry/missions-abroad/reforming-diplomacy-clear-choices-new-emphases
27. The number of staff, sent out by the Ministry of Foreign Affairs to overseas missions should decrease from 1 138 people now to 885 in 2015, sent out by other ministries- from 326 now to 290 in 2015; and the number of locally employed staff should decrease from 2 334 now to 2 095 in 2015.
28. As of December 2012, <http://www.bbc.co.uk/news/world-europe-20522201>

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Chapter 5

Administrative regulation and supervision

This chapter presents reforms in the area of administrative regulation and supervision. Administrative regulation refers to regulation by ministerial divisions or agencies, as opposed to the legislature, the government or ministers. Supervision refers to the monitoring of compliance with regulations and sanctioning of non-compliance. The chapter makes a distinction between economic regulation, which concerns market accessibility, prices and quantities, and social regulation which concerns the quality of goods and services that are sold on markets or provided by the government.

This chapter describes three reforms that correspond to broad recent trends in the area of administrative regulation and supervision. These trends are: 1) maximising the use of economy-wide and cross-sectoral regulation, in preference to sector-specific approaches, 2) broadening the use of independent and/or arm's length regulators, in preference to carrying out regulatory tasks within government ministries, and 3) adopting risk based approaches to regulatory inspection and auditing activities.

Introduction

Reform trends

This chapter discusses three major changes in the organisation of administrative regulation and supervision in OECD Member countries. In each case, the changes described constitute long-term trends, albeit that the rate of dissemination among the OECD Membership and beyond has varied significantly. The three reforms are:

- maximising the use of economy-wide and cross-sectoral regulation, in preference to sector-specific approaches;
- broadening the use of independent and/or arms-length regulators, in preference to carrying out regulatory tasks within government ministries per se; and
- adopting risk-based approaches to regulatory inspection and auditing activities.

In this context, *economy-wide regulation* refers in particular to the general competition law, which has increasingly been relied upon in many countries in place of industry-specific regulation. Similarly *cross-sectoral regulation* refers to laws that establish common regulatory arrangements for two or more industry sectors (e.g. electricity and gas), as distinct from *sector-specific regulation* which applies to only one industry, or a particular industry-segment.

Administrative regulation and supervision refers to regulation and supervision by ministerial divisions and agencies, as opposed to government or ministers. *Arm's length regulatory agencies* are those that remain under full ministerial control¹ but in the regulatory area tend to be distinguished from ministries in that they have a separate formal structure and a specified role and responsibilities. By contrast, *independent regulatory agencies* are those that are not subject to ministerial or governmental direction², except in limited forms, usually specified in legislation or some other formal instrument.

Finally *risk-based approaches* to inspection are those that imply that the past performance of regulated entities, and/or the relative level of risk posed by their operations, are taken into account by the regulator in determining which businesses will be inspected, how frequently inspections will occur and/or how detailed this inspection will be.

Each of the reforms identified can be seen as favouring both improved regulatory effectiveness and efficiency, although the balance of these two benefits differs between reforms. In the case of moves toward cross-sectoral and economy-wide approaches to regulation, at the expense of sector-specific regulation, the key driver of the reform trend is that of improved regulatory effectiveness. Similarly, the trend toward the use of arms-length and fully independent regulators is one which results primarily from the pursuit of more effective and credible regulatory outcomes. By contrast, where moves to risk-based regulatory supervision have been implemented, a key driver of the reform appears to have been the potential to maintain effective supervision while reaping substantial savings in regulatory resource costs.

The broad context within which the three reform trends identified have arisen is one in which substantial new areas of regulation had been developed over time as a result of the move away from government monopoly service provision in a range of network-based industries, such as electricity and gas, telecommunications, port services and the like. The creation of contestable markets in industries previously characterised by public

monopoly has given rise to the need for substantial new areas of regulation and, in the majority of cases, has led to the establishment of new regulators. Detailed and explicit technical regulation has had to be developed, in many cases replacing internal rules adopted by former government monopolists. At the same time, Governments have inevitably gone through a learning process in developing high quality economic regulation suited to the context of network based industries which, necessarily, have natural monopoly elements. Indeed, the core of the regulatory challenge faced by governments in this context has been on developing a body of economic regulation that will create the conditions for the development of efficient markets, particularly by facilitating the emergence of effective upstream and downstream competition.

Cross-sectoral regulation and regulatory agencies

The fact that few governments have had substantial prior experience in regulating in these contexts has inevitably meant that there has been rapid development and change over time in regulatory policies and structures, as well as in regulatory institutions, as experience and understanding of the requirements and dynamics of these new regulatory environments has developed. A fundamental and widely observed trend in terms of this regulatory evolution has been the move away from sector-specific regulation and toward cross-sectoral approaches. This trend has encompassed moves toward greater reliance on the general competition law, albeit that sector specific legislation has continued to be required in most cases.

These trends toward greater use of cross-sectoral regulation have necessarily also entailed institutional change: a widely observed change is the progressive increase in the relative importance of cross-sectoral regulatory agencies, at the expense of those that are sector-specific. This is the result of both a tendency for new regulatory agencies to be established on a cross-sectoral basis and a tendency for existing agencies to have their regulatory remit broadened when they are subject to review and restructuring.

Despite the fact that these trends have been observable since the 1990s, a substantial proportion of regulation continues to be conducted by sector-specific agencies, while it is most common for cross-sectoral agencies to regulate in closely related spheres, rather than across disparate industries. Thus, the identified trend is relatively slow-moving and incomplete. This may reflect, at least in part, the fact that at the policy level there is a clear divergence in approaches to these two aspects of the issue of reforming regulatory structures: While numerous governments have explicitly endorsed the view that the use of general and/or cross sectoral regulation should be maximised, there is no equivalent policy consensus in relation to the use of multi-sectoral regulatory agencies. Indeed, survey data from this project indicates that most countries argue in favour of a "case by case" approach to determining which form of regulatory agency should be used in any given case. The fact that there has been a long-term and widely observed trend toward the use of multi-sectoral regulators in the absence of widely adopted policy positions favouring this model is particularly notable and suggests that the trend is the result of an accumulation of pragmatic choices.

Independent regulatory agencies

A second, long-term trend in terms of the structure of regulatory agencies is that of movement away from a position in which regulation is undertaken primarily within Ministries to one in which the use of more independent models are favoured - whether that of the "arms-length agency" or the fully independent regulator. This trend is visible

in respect of both social and economic regulation, suggesting that the drivers of the trend are multiple and partly reflect broader trends in regulatory governance. However, the above-mentioned development of new areas of regulation focused on supporting effective competition in important network based industries has been an important factor. In this context, the predictability and credibility of regulatory decision-making are likely to be paramount, thus favouring the use of independent regulators. The trend toward the use of more independent regulators has apparently reached significantly further than the shift toward the use of cross-sectoral regulators, with fewer than 20% of all regulatory bodies identified in seven OECD countries responding to a survey conducted for this report being located within core Ministries.

Risk-based supervision

The third reform trend identified is that of a move toward risk-based supervision; that is, using risk assessment in relation to the regulated population in order to direct inspection and auditing resources and thus contribute to maximising the effectiveness of the regulatory implementation process. This approach originates as an asset management strategy in the private sector, particularly in relation to major hazard facilities and has, in relatively recent times, been increasingly widely adopted as policy in specific areas of legislation.

Risk based supervision seems to be more widely used in some regulatory contexts than others. In some cases, it is generally accepted as a best practice and promoted by some key international organisations. In others, however, it is almost unknown. Perhaps reflecting the historically greater focus of regulatory reform on regulatory design and development, rather than implementation, very few countries appear to have adopted a broad commitment to implementing risk based inspection strategies throughout their regulatory systems. The major exception is the United Kingdom, which implemented a comprehensive strategy in response to the Hampton Report of 2005. This programme appears to have achieved its goal of enabling a substantial reduction in inspection costs, of around one third, without compromising regulatory effectiveness. This appears to be an area in which whole of government policy initiatives could enable significant resource savings to be achieved by improving the dissemination of a relatively widely used good practice.

Reform 5.1. Reforming economic regulation: maximising the use of general and cross-sectoral regulation and regulators

Characteristics of the reform

A majority of OECD countries have undertaken substantial reform of network-based industries over the past two decades, moving from government monopoly to competitive (and largely private) service provision. This has given rise to whole new fields of economic regulation. The regulatory approaches adopted have in most, though not all, countries tended to favour the use of sector specific regulation and regulatory authorities. However, the accumulation of regulatory experience has led to further reforms, with a clear move toward a greater emphasis on using economy-wide and cross-sectoral regulation as far as possible now being apparent. This move reflects a new focus on ensuring consistent, best practice regulatory approaches across different industries. An inevitable accompanying trend has been toward the creation or expansion of cross-sectoral regulators and toward an expansion of the power of competition authorities.

Where did it occur?

Within the European context, only Germany³, Latvia and Luxembourg have established wider-ranging multi-sectoral agencies that are responsible for regulating a number of unconnected industries. However, this model is found more frequently at sub-national government level in Canada, Australia and the US, while New Zealand's Commerce Commission is both the competition authority and a multi-sectoral regulator. Interestingly, Sommer (2001) suggests that multi-sector regulators with broader remits may be more common in the developing country context.

Analysis

Regulatory reforms in the European Union

Major reform in this area has been undertaken within the European Union. In 1999, the EU commenced a review intended, *inter alia*, to maximise the scope of application of the general European competition law. By implication, this would tend to minimise the use of sector-specific economic regulation. The regulation of telecommunications provides a clear example of rapid and substantial movement in this area. According to Knieps and Zenhausern (2010):

"The Commission's Recommendation (2003/311/EC) started with eighteen relevant markets, in need of sector specific regulation (European Commission, 2003a). Four years later, the Commission's Recommendation (2007/879/EC) cancelled after all eleven of these markets."

Thus, the number of markets within this sector identified as potentially requiring sector-specific rules was more than halved within four years. While changes in competitive conditions may well have played a role⁴, a significant aspect of Recommendation 2007/879 is the identification of three criteria that should all be met before sector-specific rules are applied. These are:

- the presence of high and non-transitory barriers to entry, whether these may be of a structural, legal or regulatory nature;
- a market structure which does not tend towards effective competition within the relevant time horizon⁵;
- the insufficiency of competition law alone to adequately address the market failure(s) concerned.

Moreover, the 2007 Recommendation argues "The fact that this Recommendation identifies those product and service markets in which *ex ante* regulation may be warranted does not mean that regulation is always warranted."⁶

Kerf et al (2005) argue, on the basis of a review of the evolution of telecoms regulation in five countries, that the general competition law has largely been successful in dealing with abuses of dominant position and merger proposals, with the necessary role of sector-specific regulation being essentially limited to dealing with a range of predominantly network related issues. Specifically, they highlight the need to use sector-specific regulation to:

- Specify interconnection prices and conditions;

- Set the prices of resale services and perhaps the conditions under which the incumbent should provide unbundled access to the local loop;
- Allow number portability, carrier pre-selection and roaming;
- Control end-user prices in market segments where competitive pressures remain weak;
- Impose certain types of structural remedies, such as vertical separation between different market segments; and
- Define and fund universal service objectives and allocate rights to use spectrum.

Regulatory reform in New Zealand

New Zealand provides a rare example of convergence toward a similar regulatory position from the opposite direction. It was one of few countries that initially relied totally on the general competition law to regulate the newly privatised network industries, but has subsequently moved to supplement this approach with some sector-specific regulation. However, while New Zealand's experience showed that the general competition law was insufficient in itself to provide an effective regulatory framework for the sector, the move toward sector-specific regulation has sought only to supplement its application in specific areas in which shortcomings have been identified, rather than seeking to supplant it. Key problems with the use of the general competition law were:

- Delays in obtaining regulatory results, due to reliance on courts, arbitration or self-regulation, with associated high cost levels;
- Lack of a clear access framework, together with inability to ensure that access pricing was cost-based;
- Lack of transparency as to the element of Universal Service Obligations included in network interconnection prices; and
- Cross-subsidisation of contestable services by vertically integrated companies (Rebstock, 2004).

The bulk of these deficiencies relate to network-based market power, indicating that the New Zealand experience ultimately supports the EU view that these are the key areas which are likely to require sector-specific legislation, with the general competition law being the appropriate vehicle to deal with the remaining regulatory issues. Patterson (2004) notes that the New Zealand government highlighted from the outset, its willingness to go down the path of sector-specific legislation should the general competition law prove inadequate to the task.

A third approach to this issue - arguably constituting a "middle path" - was taken in Australia, which added new provisions to its general competition law that were designed specifically to deal with access issues in the context of the restructuring and privatisation of network-based industries⁷. This approach appears to have been designed to ensure that access issues were seen within the general competition law context and, institutionally, provided for the competition authority to be the decision-making body on these issues, while also providing specific mechanisms adapted to the context of the network based industries.

While EU countries have moved to reduce the use of industry-specific legislation in favour of greater use of both cross-sectoral legislation and the general competition law, countries such as New Zealand whose regulatory starting point was one of complete reliance on the competition law have moved to supplement this with an element of sector specific legislation. This suggests that reform may be leading toward a point of convergence, involving an optimal combination of reliance on the general competition law and use of specific regulation.

However, the pace of reform has been relatively slow economic and technological factors driving market realities (particular as they affect the locus and extent of market power) have been very significant drivers of change. As noted, the use of sector-specific regulation is primarily required where network-based sources of market power continue to exist.

Institutional reforms

As noted above, historical practice has been that most regulators have been established on a sector-specific basis. However, research by Jordana, Levi-Faur (2010) identifies a long-term trend toward the use of multi-sector agencies, accelerating rapidly from the late 1990s. The authors' data covers a total of 48 countries spread across Europe and Latin America. It shows that around twice as many industry sectors were regulated by sector-specific agencies as by multi-sectoral agencies in 1997, but that the numbers had almost equalised (37% vs. 35%) by 2007. This trend is more marked when only European Union countries are considered, with 45% of sectors regulated by multi-sector agencies compared with only 37% by single sector agencies. Multi-sectoral agencies are most common in the utilities, financial services and insurance sectors.

Jordana and Levi-Faur define a multi-sectoral agency as one that regulates more than one industry sector. This is arguably a relatively narrow definition, since it leads to bodies that regulate two, related sectors within a given industry as being defined as "multi-sector agencies". This definitional approach is highly significant to their reported conclusions, as the data indicate that multi-sectoral agencies tend to be responsible for two or more sectors in closely related areas - for example, having responsibility for different sectors within the financial system, or for both gas and electricity regulation⁸.

Other research also highlights the fact that regulatory agencies that have regulatory responsibility for a wider range of sectors, including sectors that are not economically related in any direct sense, are relatively uncommon. Thus:

1. While gas and electricity regulation is frequently undertaken by a single agency, virtually all of the members of the Council of European Energy Regulators are energy-specific regulators, with only a few members also including responsibility for water regulation.
2. While most EU countries have established single regulators to deal with both electricity and gas regulation, essentially as a response to recognition of the goal of creating a single European energy market, within Europe only Germany, Latvia and Luxembourg have developed regulators with broader remits (Genoud, Finger, 2002).
3. Similarly, while post and telecommunications regulation is undertaken by a single authority in around half the member agencies of the Independent Regulators Group, almost all of these regulators is communications-sector specific.

The observed trend away from sector-specific regulators is, perhaps, unsurprising given the above-discussed changes in regulatory approach. However, there is significant divergence in government policy positions on these two regulatory policy issues. While many governments have explicit policies favouring the use of generally applicable regulation, there is little evidence of policy explicitly favouring the use of multi-sectoral regulators. Indeed, most responses to the survey questionnaire completed for this study emphasised the need to assess this issue on a case-by-case basis, in the light of the specific regulatory environment. Thus, the trend toward the use of multi-sectoral regulators is apparently largely organic, reflecting the accumulation of individual policy choices, rather than being driven by conscious policy.

This lack of a clear policy position likely reflects the fact that the theoretical literature does not reach a clear conclusion as to whether regulators should be organised on a sector-specific or a multi-sectoral basis⁹. Rather, most references highlight a range of benefits and drawbacks of the two competing models and suggest that the balance between these is likely to differ in individual circumstances, while differing policy objectives are also likely to be relevant to the final choice.

The major benefits of sector-specific agencies highlighted by their proponents include superior ability to develop a critical mass of sector-specific regulatory expertise, reduced risk of the agency becoming unduly influential within the policy space and their ability to facilitate regulatory experimentation, by allowing different regulatory approaches to be adopted in different sectors. Supporters of multi-sectoral agencies, by contrast, highlight the benefits of regulatory consistency, particularly where there is technological convergence or product bundling, economies of scale and scope in regulation and reduced risk of regulatory capture.

Multi-sectoral regulators are likely to have particular advantages in relation to sectors subject to technological or commercial convergence¹⁰ and other cases where there is a need for a co-ordinated regulatory approach to different sectors (e.g. where companies from a number of sectors all need the same right of way for their networks). In practice, even where multi-sectoral agencies with broader scope are used, the focus appears largely to be on the regulation of network-based industries. Thus, for example, Germany's multi-sectoral regulator is the Federal Network Agency, responsible for Electricity, Gas, Telecoms, Post and Railways, while Latvia's is the Public Utilities Commission. Most Canadian provinces have "public utilities" boards¹¹. This may suggest recognition of the commonalities involved in terms of the task of regulating network industries, notably the need to determine the terms of access to essential network infrastructure. Jordana and Levi-Faur (2010), argue that:

"...the option to concentrate regulatory activities in a multi-sector agency, covering different sectors in a process of convergence, becomes an opportunity to pursue an institutional reform aiming, arguably, to promote efficient markets. Sectors such as electricity and gas, financial services, transportation or information and communication technology have since the 1990s been susceptible to these convergence processes."

While most multi-sectoral agencies regulate only a few, closely related sectors, there does seem to be some evidence of these bodies having their remit expanded over time, possibly as a result of governments, when faced with regulatory problems in a particular sector, opting to use the services of bodies that have established a track record as an effective regulator in a range of fields. An example of this expansion is given by the Essential Services Commission in Victoria (Australia), which has seen its original responsibilities for energy, water and ports expanded to include conduct of *ad hoc*

inquiries on pricing and related issues in relation to a range of transport modes (e.g. taxis) and the insurance industry, as well as taking on a role in reviewing local government bodies¹².

Unsurprisingly, the broadening of the remit of an existing regulatory agency seems to be particularly common in circumstances in which more than one regulator has been involved in the regulation of different parts of a single industry sector. For example, Thatcher (2006) highlights the example of the finance industry in the UK, with the establishment of the Financial Services Agency as the industry-wide successor to several previous regulators. Similarly in Australia, the Australian Prudential Regulatory Authority (APRA) was founded in 1998 as the first regulator to have responsibility for the whole of the financial sector¹³. More broadly, Thatcher notes that where existing independent regulators are replaced or reconstituted, there is a trend toward broadening of their remit.

Jordana and Levi-Faur (2010) show that, while agencies do tend to broaden their remit over time, this is most commonly via expansion of an existing agency into an area not previously subject to regulation by an agency, rather than via merger of existing regulatory agencies. Thus, only 18% of the MSA identified were created via such mergers, compared with 43% becoming MSA via the expansion of a sector-specific agency into a new area and 39% being created *de novo* to regulate areas not previously subject to regulation.

The above has highlighted the expectation of performance gains as a driver of the trend toward the remit of regulatory agencies being broadened over time. The expectation of regulatory cost savings is likely also to be a factor however though it is not clear how significant this factor has been in practice.

The trend toward maximising the use of the general competition law as the basis for regulating network based industries will necessarily also have implications for the structure of regulatory institutions. Specifically, it will tend to expand the remit of the competition authority itself, while it is also logical to expect an accompanying trend away from the use of sector-specific economic regulatory agencies, for four reasons.

1. First, if enforcement action under the general competition law is generally undertaken by the competition authority, the scope of action of sector-specific regulators may tend to decline over time¹⁴, making the maintenance of a "critical mass" in terms of human resources and expertise a progressively more difficult task.
2. Second, given that moves toward the use of the general competition law are substantially predicated on seeking to maximise consistency of approach to interpretation and implementation, the same pressures will tend to promote the case for multi-sectoral regulators to be used in preference to sector-specific regulators to the extent that the competition authority does not, itself, take on the regulatory role.
3. Third, cross sectoral regulators generally provide a more attractive working environment for special staff, including greater career development opportunities, and are thereby better placed to attract and retain high-quality staff, with apparent benefits for regulatory effectiveness, in comparison with sector-specific regulators.

4. Fourth, as argued by Sommer (2001), technological convergence between some sectors, as well as the commercially driven development of multi-sectoral utility companies, would require, at a minimum, effective co-ordination between sectoral regulators and may thereby create pressure toward the further development of multi-sectoral regulators.

Within the context of the objectives of the OECD Value for Money study, it appears that the multi-sectoral regulator model has significant potential to yield both regulatory cost savings and improvements in regulatory effectiveness. That said, the survey responses of the lead countries in the current study have provided little specific data on this subject.

Feasibility of the reform

As indicated above, this is an area in which EU level regulation is in place, while movement toward the same broad regulatory approach is also visible in a number of countries beyond the EU.

The reform is principles based and appears to be broadly applicable, though precise implementation details may vary across countries.

A significant contextual issue is that of the quality of the general competition law. A move toward greater reliance on the general law in preference to sector-specific legislation presupposes that the competition law is itself of high quality therefore capable of dealing with the issues formerly regulated through sector-specific legislation. In addition, Australia provides an example of a country which has added some sector-specific provisions to the general competition law. This arguably constitutes a variant of the identified reform which may broaden its potential scope.

As discussed above, the experience of the EU in implementing this reform suggests strongly that the specific boundary between the use of the competition law and sector-specific regulation will tend to shift over time. These shifts appear to reflect both technological factors and competitive conditions in the relevant industries, on the one hand, and the development of regulatory knowledge and understanding and changes in regulatory institutions, on the other.

This implies that the balance between general and specific legislation must be kept under review and adjustments made periodically in response to changes in the regulatory environment.

Reform 5.2. The use of independent regulatory agencies

Characteristics of the reform

Much of the recent, substantial expansion in the use of independent regulators has occurred in the context of restructuring former government monopolies, particularly in relation to network based industries. In this context, a key objective is to ensure market stability and a positive investment climate, leading to the achievement of long-term economic objectives. This was to be achieved by shielding regulatory decisions from the potential for political interventions to be made in pursuit of short-term political objectives. However, several OECD countries have a long history of using independent regulators and arm's-length agencies in fields of social regulation, while the use of these organisational forms in this context has also increased substantially. In this area too, the

desire for regulatory decisions to be consistent, predictable and apolitical appears to be the major explanation for the increasing preference for this organisational form.

Where did it occur?

There has been a steady trend toward the use of independent regulators visible across a wide range of countries since the 1990s, both within the OECD membership and beyond. However, movement in this area has been relatively gradual, while the extent of the use of independent regulators varies significantly across different areas of regulation. As suggested above, independent regulators are particularly widely used in OECD countries where network based industries are concerned. For example, Genoud and Finger (2002) found in 2002 that there were 11 European countries with independent regulatory agencies regulating the electricity sector, compared with only five administrative bodies and one quasi-judicial body.

Moreover, in the majority of cases in which the gas industry has been restructured and opened to competition, the electricity regulator is also responsible for regulating the gas industry. This appears to reflect, at least in part, the European focus on creating a single energy market. Independent regulators are almost universal in the telecommunications industry: the Independent Regulators Group counts 34 members, including all 27 EU member states, 4 EFTA countries and 3 EU candidate countries. The importance of European level regulatory structures in the single market context presumably constitutes a factor leading toward convergence in institutional structures. However, the virtual consensus on the use of independent regulators in these network-related industries extends beyond Europe to other countries such as the United States and Australia.

As the above suggests, these independent regulators were usually established on a sector-specific basis; that is, each regulator was responsible for one industry or even for only parts of one industry. However, as discussed under Reform 5.1, there is evidence of aggregation of independent regulators within individual industries (e.g. financial services), while regulators covering closely related industries (notably electricity and gas, post and telecommunications) are also becoming relatively common.

The increase in the use of independent regulators and arm's length agencies in preference to core ministries is observable in relation to both economic and social regulation, although it appears to be more pronounced in the former sphere. Table 5.1 provides an overview of the current status of social and economic regulators in seven countries that have participated in the Value for Money study and completed questionnaire responses on this issue¹⁵.

Table 5.1. Number of supervisory/regulatory authorities by status

		Australia	Austria	Denmark	Netherlands	Norway	Spain	Sweden	Total*
Social	CM	5	4	0	14	0	n.a.	0	23 (22.1%)
	ALA	3	1	30	3	19	n.a.	7	65 (62.5%)
	IA	6	0	0	6	4	n.a.	0	16 (15.4%)
Economic	CM	3	1	0	2	0	0	0	6 (7.9%)
	ALA	8	1	5	1	7	0	23	45 (59.2%)
	IA	12	2	0	3	2	6	0	25 (32.9%)
Total		37	9	35	29	32	n.a.	30	172

Note: * Percentages given within each area of regulation - i.e. social or economic.

Key: CM: Core Ministry; ALA: Arm's Length Agency; IA: Independent Agency; *n.a.*: Not Applicable

On the basis of the data for the seven Value for Money countries presented in this table it is clear that regulation via the agency model, rather than core ministries, is preponderant in both social and economic sectors. However, the use of core ministries as regulators is much less common in the economic sphere than the social sphere (7.9% vs 22.1%). Conversely, the use of independent agencies is substantially more widespread in the economic regulatory context (i.e. 32.9% of the total vs. 15.4% in social regulation). Arm's length agencies are about equally used in the two areas.

Analysis

Significant differences between countries

The establishment of independent regulators is seen as a means of minimising the risk of regulatory capture by creating a buffer between political lobbying and regulatory decision-making, thereby ensuring that decisions consistently favoured efficient market outcomes and the interests of consumers.¹⁶

In a small number of OECD countries there is a long history of the use of independent regulators (e.g. the United States) or of arms-length regulatory agencies (e.g. Sweden). However, the restructuring and (frequently) privatisation of a range of network-based industries that were formerly government monopolies in most countries has been the catalyst for a substantial expansion in the use of independent regulators across a wide range of countries both within the OECD Membership and beyond. Moreover, while this expansion apparently began with the network sectors, it has since spread to other economic regulators, in areas such as the finance industry, and into the field of social regulation.

Nonetheless, the data set out under Reform 5.1 for the Value for Money countries highlights the continued existence of some significant differences between countries. For example, Austria and the Netherlands continue to use a majority of core ministries among social supervisors/regulators. Of the remaining five countries only Australia makes any use of core ministries as social regulators. Within the context of economic regulation there is a clear divergence between the three Nordic countries, which strongly favour arms-length agencies¹⁷ and the remaining four countries, which strongly favour independent agencies. A similar, though less pronounced trend is visible in social

regulation, where the Nordic countries again favour arms-length agencies while the other countries using the agency model (Australia and the Netherlands) favour independent agencies. The responses to the Value for Money questionnaire indicate that a number of these differences are the result of historical factors, based on constitutional or other constraints, as discussed below.

Jordana and Levi-Faur's (2010) larger dataset, covering 48 European and Latin American countries, also supports the conclusion that "agencification" is widespread in relation to both economic and social regulation, but is more extensive in the former area. Thus, while 74% of all sectors studied were regulated by independent agencies, only 55% of sectors subject to social regulation are conducted by these bodies. That said, the difference is less marked in EU Countries (82% vs. 68%) than in Latin American countries (68% vs 38%)¹⁸. Notably, the authors also find that the overall extent of agencification (i.e. the use of arm's length or independent agencies, rather than core ministries) is positively correlated with the use of multi-sectoral agencies. Thus, for example, they find that the finance sector shows both the highest level of agencification and the highest level of multi-sectoral agencification, while the utilities sector scores slightly lower in both cases.

Importantly, Jordana and Levi-Faur also identify "clear evidence of the importance of path dependence in the establishment of multi-sector agencies", noting that the establishment of a multi-sector agency comes about far more frequently via the expansion of the scope of an existing agency into an unregulated sector than as a result of the merger of existing agencies. Indeed, they find the latter outcome to be uncommon. This leads the authors to speculate that:

"The costs involved in merger processes may rise after the creation of agencies, because of the organisational sunk costs involved and the institutions' and actors' constellations already created around the agency. In this sense, institutional path dependence of already existing agencies may represent an obstacle to new waves of agency merger in the future."

Resistance to change from existing agencies is also suggested as another factor that may inhibit further movement toward the multi-sectoral approach. These observations have clear relevance for policy-makers.

Both the responses to the Value for Money survey and the research literature suggest that countries' experiences with the more widespread use of independent regulators and arms-length agencies have been generally positive. Research by Thatcher (2006) finds that independent regulators have largely been free from overt political influence in the European context. Moreover, Ministers have rarely made partisan appointments to the regulatory agencies and rarely dismissed incumbents, who generally serve long terms. The budgets and staff of independent regulators, though relatively small, have tended to grow over time. Independent regulators have rarely been abolished, rather, where changes have been made these have usually been in the direction of broadening their remit -- a finding that is clearly consistent with the results of Jordana and Levi-Faur's research. The independence of these bodies from direct political intervention has often been cited as helping to build trust among investors in newly liberalised and privatised sectors.

Policy position

While experience to date with the use of arm's length or independent agency model is generally regarded as being positive, almost all OECD countries retain a mix of

regulatory models embracing some level of regulation by ministries, as well as these other organisational forms. Importantly, the current mixed model appears to reflect the current policy position of governments, rather than being an indicator of an incomplete reform process.

Most countries that responded to the survey questionnaire administered as part of this project stated that regulatory models are determined on a "case by case" basis, depending on the requirements of the specific regulatory environment. Moreover, few identified a generally applicable policy to guide this choice and ensure optimal approaches. This implies that future changes in this area of the organisational structure of regulators are likely to be driven, not by a conscious and generally applicable policy but, rather, by an *ad hoc* approach.

Relatively little information was provided as to the considerations weighed in making these *ad hoc* judgments. However, it appears that key factors weighed in favour of independent regulators, consistent with the literature on this issue, are ensuring the credibility of the regulatory structure by demonstrating its independence from political interference and its transparency, thus providing a guarantee of consistent regulatory decisions serving clearly articulated (usually in legislation) regulatory goals and priorities. Responses also tended to indicate a clear preference for the use of independent or arm's length agencies in the context of regulatory tasks requiring high levels of specific, technical skills.

On the other hand, regulation by ministries is seen as desirable where policy related roles constitute a significant element of the task. This applies in particular to "inspectorates" which are common in various European countries in the area of social regulation. Inspectorates have tasks in the sphere of monitoring and sanctioning, but not of regulation (rule making) per se. They are sometimes seen as the "ears and eyes" of the ministry and they can have important tasks in policy development by advising the minister about new policies or legislation. These tasks are sometimes seen as incompatible with an independent position.

Spain was one of few countries to identify a clear trend in terms of the structure of regulators in its questionnaire response. It highlighted a sustained move toward the creation of a range of arms-length agencies constituted under its 2006 Agencies Act, with all regulatory bodies expected to be transformed into agencies in the near future. A number of objectives of this move have been highlighted. In relation to recently liberalised industries, the need to maximise competition and ensure its fairness, by making decisions independent of both political interference and lobbying from market participants, was highlighted. Objectives of maximising transparency and accountability were also noted, including the need for the objectives of each agency to be apparent to citizens and for managers to be accountable for their achievement. Achievement of these goals is, in turn, seen to be crucial to ensuring public confidence in the regulatory arrangements. Financial independence was seen as crucial for independent regulators, with the budgets of both the energy and telecoms regulators deriving from a levy payable by all market participants.

Canada highlighted its "pragmatic and incremental" approach to changing organisational forms and states that, rather than there being a discernible trend in any particular direction, a "form follows function" approach is adopted. This approach sees the need for different balances to be struck between the basic objectives of autonomy and accountability in different contexts. Thus, the issue of whether the organisation requires an arms-length status in order to meet its objectives or whether the responsible Minister

needs powers to direct or influence the organisation in order to ensure the policy direction followed is consistent with government objectives and cohesive in relation to other government policies and entities will be weighed. In general terms, in Canada there has been a tendency for specialised operational functions to be housed in agencies, in addition to those with quasi-judicial roles or quasi-commercial mandates.

Sweden stated that all regulatory authorities are constituted as arm's length agencies as this is a longstanding constitutional requirement, incorporating a ban on government interference in a regulatory agency's interpretation or application.

At a fundamental level, the questionnaire responses suggest that OECD countries have had a largely positive experience in this regard: certainly, there is no suggestion of any retreat from the use of independent regulators. Conversely, only Spain among the survey respondents highlighted a conscious policy (backed by generally applicable legislation) of broadening the use of the agency model.

The emphasis of the remaining countries on pragmatic "case by case" decision-making on further agencification can be seen as surprising in the context of the clear evidence found by Jordana and Levi-Faur and others of a quite strong trend in this direction. That is, it appears surprising that such a clear trend is apparently not being driven by a strong policy position being taken by governments. That said, the authors' indicate a clear slowing in this trend from around 2002 to 2007 (the most recent year of their data collection).

Arms-length agency versus independent agency

While the above highlights the impediments to adopting the independent regulator/inspectorate model faced in some countries, there are clear reasons for favouring this approach over the arm's length agency model. Providing the ministry with information about compliance or advising the minister about new legislation is not necessarily incompatible with an independent position. There are many independent inspectorates that fulfil these roles and interlocutors from these inspectorates have confirmed that they see no intrinsic conflict of interests in this respect. However, this is different if inspectorates are tasked to monitor and enforce policies that are not anchored in formal law, but only in informal ministerial policies. An independent inspectorate may be required to refrain from openly criticising the legislation it is supposed to uphold while internally advising the minister to adjust or even abolish it, if the inspectorate sees problems in its execution or enforcement. However, such a requirement is fundamentally problematic when it concerns ministerial policies that are not in any form enacted in law. An independent inspectorate must be able to openly criticise ministerial executive policies that have no formal status and that cause problems. This important role of independent inspectorates is often not appropriately fulfilled or not fulfilled at all if the inspectorate has no independent status.

In particular, the Dutch country review (OECD, 2011) highlighted the need for independent inspectorates to be able publicly to criticise government policies and actions that are not legislatively based and the fact that arm's length agencies are often unable to effectively pursue this role. In addition, it is likely that the degree of perceived independence from government interference will be greater in the case of independent regulators, thus suggesting that the benefits cited above in terms of confidence in the regulatory structure and its impartiality will be greater when this structural option is employed.

Given these factors, countries should adopt transparent policies based on clear and consistent criteria to drive the choice of regulatory structures. These should enable all structural options to be assessed. Where legislative or other impediments to the use of independent regulators exist, their appropriateness should be reviewed as part of the formulation of these policies.

Feasibility of the reform

As discussed above the independent and arm's-length regulator models are used to greater and lesser degrees in virtually all OECD Member countries and in a wide range of non-OECD countries. Indeed, 83% of the regulatory bodies identified in the seven Value for Money countries included in Table 5.1 are either independent or arm's length, while all seven countries have more than 40% of regulatory bodies composed of one or the other of these models. As such, this is a reform that must obviously be seen as broadly applicable.

Questionnaire responses indicate that country-specific factors do affect the extent of their use and the contexts in which they are employed. In particular, these factors appear to be important in explaining the choice between independent regulators and arm's length agencies. As noted above, the Nordic countries use arm's length agencies exclusively, while most other Value for Money countries for which data are available have been more likely to favour independent agencies. Sweden notes that the choice of arm's length agencies reflects constitutional requirements, while Spain cited general legislation (the Agencies Act 2006) which requires all agencies to be constituted in this way.

Given these factors, there would clearly be impediments to the adoption of the independent regulator model in some countries. However, while arm's length agencies are in some respects an imperfect substitute for an independent regulator, specific protections provided to these bodies in the Nordic countries suggests that the difference between the models in this specific context is likely to be less than in some other environments.

Both the survey responses obtained for this project and the regulatory literature suggests that the independent regulator model has been broadly successful. Despite this, many governments have to date only moved to adopt this approach in certain areas and have been more likely to adopt this model in the context of economic regulation than in social regulation. Moreover, the rate of change observed appears to have slowed.

While governments state that they adopt pragmatic, case by case approaches to analyse what regulatory model is most appropriate in a given context, there is limited evidence of clear criteria and consistent approaches being taken. The success to date of the independent regulator model suggests that efficiency and effectiveness gains are available from adopting a programme to maximise its use, based on explicitly determined appropriateness criteria (both general and country-specific). In this context, particular consideration should be given to the scope for a wider use of the independent regulator model in relation to social regulation.

Reform 5.3. Risk based supervision

Characteristics of the reform

An important reform in the area of regulatory implementation and enforcement has been to move the practices of regulatory agencies away from the use of periodic inspections that do not differentiate among regulated entities and toward risk-based

approaches. As a corollary of this move, risk-based approaches to enforcement activity aim to ensure that sanctions adopted in particular circumstances are proportionate to the relevant risks and that a rational, programmed approach to escalation of sanctions occurs in cases of continuing non-compliance. Improving practice in these areas has the potential to improve regulatory effectiveness, to yield savings to government budgets and to reduce regulatory compliance costs.

Where did it occur?

Perhaps reflecting the historically greater focus of regulatory reform on regulatory design and development, rather than implementation, very few countries appear to have adopted a broad commitment to implementing risk based inspection strategies throughout their regulatory systems. The United Kingdom has been a pioneer of this reform.

Analysis

The risk based inspection and auditing model originates as an asset management strategy in the private sector, particularly in relation to major hazard facilities. In relatively recent times, it has been increasingly widely adopted as policy in specific areas of legislation.

International organisations have in some cases promoted this approach as regulatory best practice in particular contexts. For example, the UN's Food and Agriculture Organisation promotes risk based inspection as "a vital element of a modern food control system"(FAO, 2008). Similarly, the European Union has published its "CWA 15740:2008 - Risk-Based Inspection and Maintenance Procedures for European Industry (RIMAP)" in order to encourage a harmonisation of regulatory practices in the petrochemical, chemical, steel works and power industries around this concept within Member states.

In the UK the key driver of the reform was the Hampton Report of 2005 (Hampton, 2005) The reform was initially promoted primarily as a means of reducing administrative burdens incurred by business:

“Administrative burdens are the costs that come from enforcement activities. If regulators operate effectively, and use the best evidence to programme their work, administrative burdens on compliant businesses can be reduced while maintaining or even improving regulatory outcomes [.....]”.

“Risk assessment should be comprehensive, and should be the basis for all regulators’ enforcement programmes. Proper analysis of risk directs regulators’ efforts at areas where it is most needed, and should enable them to reduce the administrative burden of regulation, while maintaining or even improving regulatory outcomes”(Hampton, 2005:1).

The potential for improved regulatory effectiveness is also recognised here, although the potential for cost savings to be reaped by regulators is not explicitly acknowledged. Nonetheless, it follows that, if resources are freed for redeployment as a result of an efficiency gain, there is necessarily potential either to redeploy them to obtain additional regulatory benefits, to reduce overall regulatory costs, or to achieve some combination of the two outcomes.

Hampton recommended that all inspections should be based on risk analysis, arguing that "no inspection should take place without a reason". Hampton noted that the regulators reviewed for the report carried out 3 million inspections *per annum*, so that the

potential savings were considerable. Moreover, the same approach should be adopted in determining what data requirements businesses should need to meet. This was expected to lead to reduced data collection and transmission costs for many businesses.

In addition, Hampton recommended that reforms to sanctions regimes to ensure more effective deterrence and reduce the need for inspection activity by increasing the disincentives for non-compliance. These included increasing maximum fines available to courts, enhancing sentencing guidelines to support better decisions on penalties and making administrative penalties more widely available and more severe where warranted. The underlying principle was that of addressing risk issues in determining appropriate penalties to be applied in individual cases, including issues of penalty escalation. In order to give expression to these principles, the Macrory review was commissioned, with terms of reference requiring it to articulate principles relevant to the introduction and operation of civil, administrative and criminal sanctions, clarify the relationship between these different sanctions types, identify areas in which the use of administrative or alternative sanctions may be appropriate and what limits on their use were appropriate. The findings of this review led to substantial reform being adopted, in part via the Regulatory Enforcement and Sanctions Act 2007.

The Hampton recommendations were accepted by government and a substantial programme was adopted to ensure that they were implemented across the full range of government regulatory agencies. Commencing in early 2007, "Hampton Implementation Reviews" were carried out on 36 national regulators. Reviews were conducted by external teams including staff from the Better Regulation Executive and the National Audit Office, as well as other relevant agencies. The NAO and BRE jointly published guidance for review teams in early 2007 (National Audit Office, 2007).

These reviews sought to determine the extent to which current agency practices were consistent with the recommendations of the Hampton and Macrory reviews and to encourage "continuous improvement" in this regard by identifying specific issues to be addressed¹⁹. Hampton's original report found that many regulators did adopt risk assessment practices in much of their work. Thus, the reform sought not to impose an entirely new paradigm but, rather, to expand the use of a currently employed tool and make its use more systematic.

The reviews were conducted over approximately a three year period and were completed in December 2009. The next step in the process is the completion of a series of "Progress Reports". These are described as:

"Additional reviews of selected regulators who have already received their Hampton Implementation Review. [...] These reviews assess the progress of regulators in implementing the recommendations made in their full Hampton Implementation Reviews".

Only one of these progress reports had been published at the time of writing.

The "Post-Hampton Implementation Review Process" generally found that most agencies had achieved significant progress in implementing risk-based approaches. However, the review also included a list of "issues to be followed up", highlighting areas in which consistency with the Hampton/Macrory recommendations could be improved. While these necessarily differ across agencies, common issues appear to include the need to conduct better data analysis to support the adoption of risk assessment based processes, implementing more critical assessment of existing data requirements to reduce regulatory burdens on firms, ensuring that decision-making is consistently outcome or output

focused and ensuring that organisational commitment to Hampton/Macroroy reform concepts and rationales are effectively transmitted from agency management to staff dealing directly with regulated firms from day to day.

Moves toward the use of risk based approaches are also being made in a number of other OECD Member countries, particularly in relation to the design and implementation of regulatory inspections programmes. For example, the report of a recent inquiry into food regulation in Victoria (Australia) recommended that enforcement authorities should adopt risk-based inspection programmes in preference to current arrangements in which a large proportion of inspections are driven by statutory "triggers" such as annual renewal of registration or change of ownership.

However, the responses to this recommendation provide a challenge to aspects of the Hampton approach. Where Hampton sees inspection as part of the enforcement pyramid and ill-directed inspection activity as diverting resources that could be better allocated to advice provision, Victorian food regulators argued that these two functions were largely integrated in practice. Thus, while the general principle of risk based inspection was accepted, it was argued that annual inspections on renewal of registration should be retained as they constituted an important means by which advice was provided to regulated businesses, with the great majority of non-compliance detected being dealt with via advice provision rather than the levying of penalties or even, necessarily, rectification orders and re-inspections. Moreover, in this view, maintaining regular contact with the regulator through the annual inspection mechanism was an important means of maintaining relationships which then facilitated a more constructive approach to maintaining and improving regulatory compliance and performance standards generally²⁰. Other Australian regulators have also explicitly acknowledged the dual role of inspectors in both providing advice and carrying out enforcement activity where required.²¹

Importantly, similar observations have been made in the UK context. The post-HIR progress report for the Environment Department found that:

"Stakeholders noted that, while a reduced number of inspections had benefits, they also wanted to maintain contact with an officer, for purposes of advice." (National Audit Office, 2010:4)

The progress report highlights this "tension" between reduced inspections and firms' desire to maintain contact with regulatory officials, but does not comment on either the implications of this finding for the original Hampton recommendations or any strategic approaches that might be taken to address the tension. However, this issue appears an important one to address in the context of moves to implement the concept of risk driven inspection regimes in practice. In contexts in which the average inspection frequency is low, the scope for reorientation of inspection activity in response to risk assessments may be limited, particularly if it is accepted that there is merit in maintaining some degree of regular contact with regulators.

While the Hampton Report appears to envisage a clear division between advice services and enforcement activity (including inspections), the above suggests that such a division may increase regulatory costs and/or reduce the effectiveness of advice provision. Moreover, while some regulators have noted the conflicts inherent in their dual role as advisers and prosecutors, with firms often reluctant to seek advice for fear of opening themselves to prosecution by revealing non-compliance, this conflict would not appear to be reduced through separation of advice and "inspection" into discrete contacts. Rather, it exists as a result of the dual role of the organisation.

Feasibility of the reform

The reforms discussed above would appear to be transferable to many OECD countries. Indeed, work by the OECD's Programme on Regulatory Management and Reform documents moves toward the adoption of risk analysis as a tool for better regulation in a number of countries. Moreover, Macrory's recommendations regarding sanctions arrangements are generally consistent with the results of work on compliance and enforcement adopted by the Dutch government in the 1990s (OECD, 2002:79), while Australia has also introduced reforms along these lines in some areas.

A key implementation issue is that of ensuring that adequate data is collected and appropriately analysed to support risk-based supervisory approaches. In part, problems arising in this area reflect the fact that systemic adoption of risk-based approaches requires more thoroughgoing changes to regulatory/supervisory practices than was perhaps initially appreciated. However, some data challenges will undoubtedly remain in the long term, as in many aspects of public policy. Thus, constraints will remain on regulators' ability to act in ways that are fully directed by risk assessments.

The issue of inspection practices seems to be an area of particular challenge in this regard. Relatively low levels of detection of non-compliance can frequently mean that regulators' abilities to create risk-based profiles to guide inspection activity may be limited, while the ability to determine the expected consequences of non-compliance in different contexts may be another limiting factor. Moreover, even where these issues can be overcome, low overall inspection frequencies, the dual role of inspection as an advisory function as well as an enforcement mechanism and the asserted need to ensure a minimum level of contact with regulated parties may all restrict the potential for redirection of inspection resources along risk-based lines.

In sum, the concept of risk-based supervisory practice is widely regarded as sound, while the Hampton Implementation Reviews suggest that significant gains can be made in practice through their adoption. However, a number of significant implementation issues are likely to arise in specific contexts and must be recognised and managed carefully.

Note

1. See definition in the glossary.
2. See definition in the glossary.
3. As noted by Jordana, Levi-Faur (2010), "*from the early 2000s the German government gradually established the Bundesnetzagentur, a multi-sector giant regulatory agency, nowadays responsible for electricity, gas, telecommunications, post and railways.*"
4. Recommendation 2007/879 declares that the "*aim of the regulatory framework [is] to reduce ex ante sector-specific rules progressively as competition in the markets develops.*"

5. The application of this criterion involves examining the state of competition behind the barriers to entry.
6. Indeed, Knieps and Zenhausen argue that the proper application of the three criteria suggests that only two of the seven markets identified in the 2007 recommendation continue to require *ex ante* regulation under the underlying logic of the recommendation.
7. Part IIIA was added to the Trade Practices Act in 1994.
8. The following list of energy regulators indicates which have multi-sectoral responsibilities: www.iceregulators.net/appl/html/IERN_WFER_II/EnergyRegulatorsList.pdf.
9. Jordana, J., Levi-Faur, D. (2010), op cit..
10. Commercial convergence here implying that the same organisations are offering a "bundle" of services from different industries (e.g. telecoms and electricity) even though there may not be a technological link between them.
11. Though Nova Scotia has a "public utilities and review" board that has supervisory responsibilities for tramways and buses, as well as energy and water.
12. See: www.esc.vic.gov.au for information on the role of the ESC and a range of inquiry reports.
13. In the Australian context, this broadening of regulatory roles required Federal/State co-operation for its achievement, with State governments referring their powers over aspects of the financial system to the Federal government to enable the establishment of the Australian Prudential Regulatory Authority.
14. In the Australian case, in which the general competition law was expanded to include specific access rules, the competition authority itself has had responsibility for the relevant regulatory functions. However, this model has not been used in other OECD countries.
15. No list of supervisory/regulatory authorities has been provided by Canada, Finland, New Zealand.
16. See, for example, OECD (2002) "*Regulatory Policies in OECD Countries: From Interventionism to Regulatory Governance*".
17. Note, however, that arm's length agencies in Nordic countries are not subject to ministerial responsibility for the handling of individual cases.
18. The dataset includes all OECD countries, plus 19 Latin American countries. Data for the OECD as a whole are not presented separately.
19. In 2006 Richard Macrory was asked to review regulatory sanctions to ensure they were appropriate to a risk-based regulatory environment as recommended by Hampton. Government also adopted the Macrory recommendations (Macrory, 2006).
20. See Inquiry into Food Regulation in Victoria. Inquiry reports and submissions available at www.vcec.vic.gov.au.
21. See, for example Worksafe Victoria (2005).

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Chapter 6

Support services and operational management

This chapter presents reforms in the area of operational management and support services. Operational management is defined as decision-making about the use of operational means, namely: finance (budgeting, accounting, cash and debt operations), human resources and organisation, internal audit, procurement, information and ICT, accommodation, real estate and facilities (office equipment, reproduction, cars, catering, security, cleaning and internal post), communication. Support services include advice on the use of operational means, as well as the execution of support tasks.

Operational management is a task of managers in ministries and agencies, but standards of operational management set limits to the managerial autonomy. Such standards are set by central ministries (for instance the Ministry of the Interior for human resource management and the Ministry of Finance for finance management). Setting of de-central standards can be delegated to the Permanent Secretaries of ministries.

In the era of New Public Management there was a trend towards decentralisation of support service units towards sectoral line managers. This trend has been reversed. Current trends go in the direction of bringing back support service units in central ministerial directorates, sharing of support service between ministries and levels of government, and outsourcing of support services. The reforms in this chapter are examples of these trends. Furthermore one reform concerns the streamlining of standard setting by concentration of central standard setting authority in one or two ministries.

Introduction

What are support services?

For the purpose of the Value for Money study support services are defined as services to support managers in the area of operational management. Operational management is decision-making about the use of operational means, namely:

- finance (budgeting, accounting and cash- and debt operations);
- human resources and organisation;
- internal audit;
- procurement;
- information and ICT;
- accommodation, real estate and facilities (office equipment, reproduction, cars, catering, security, cleaning, internal post);
- communication.

The tasks of support service units include advice on the use of operational means, as well as the execution of support tasks, for instance running a salary administration in a ministerial human resource division, running a financial administration (budgeting and accounting) in a financial division. It may also include advice on the interpretation and application of government-wide and ministerial standards of operational management.

Support services are provided to all managers in government, regardless their tasks. It may concern policy development, policy execution, administrative supervision and regulation and (other) support services¹. Traditionally support services were often organised in central governments in single support service units under the permanent secretary of each ministry.

Support services should be distinguished from the primary process of ministerial divisions. For this reason, legal advice is not considered as a support service although it is sometimes organised in separate units under the permanent secretary. The preparation of laws and regulations belongs to the primary process of almost all policy development units and legal expertise is often integrated in the policy development units themselves. In many cases legal units are organised within the policy development units of the ministry, so that the legal unit under the permanent secretary mainly serves to assist the units that lack internal legal expertise.

Similarly, the management of ICT systems, once they are developed and in place, usually belongs to the primary process of many policy development and policy execution units and should not be seen as a support service (the development of ICT applications certainly belongs to ICT support). Only ICT systems that can be seen as belonging to the primary process of the ICT support units themselves can be seen as support services (see Chapter 9).

What are standards of operational management?

Managers are not entirely free in the use of operational means. They are bound by standards of operational management. Standards are rules about the use of operational means. For instance in the area of finance, they describe the rules for budgeting,

accounting and cash and debt operations, as laid down in the Budget Code and elaborated in decrees of the Ministry of Finance. In the area of human resources, these rules describe the procedures for recruitment, pay setting, performance assessment, promotion and pensions. In the area of accommodation, they describe the office equipment available to each employee and the number of square meters of office space, etc.

Setting of standards of operational management is an internal policy making task that is carried out by central ministries. The standards for finance are typically set by the Ministry of Finance. The standards for human resources and organisation are typically set by the Ministry of Public Administration. Standards for communication are often set by the Prime Minister's Office.

Government wide standards are often complemented by ministry specific standards, which are set by the Permanent Secretary, for instance for office automatisisation within the ministry or for office equipment within the ministry.

Combination of support service delivery and standard setting

Traditionally, support service units have not only supported line managers in operational management and the interpretation and application of central and de-central standards, but they have also supported the development of these standards. This combination of tasks is generally seen as favourable because standards should be developed in light of experience in operational management and the application of standards in practice. There is, therefore, no reason to plead for an organisational split between support service delivery and support of standard setting. On the other hand, it should be kept in mind that standard setting is a policy-making task (policy development with respect to operational management) and not an executive task (policy execution with respect to standards in operational management).

In this light most OECD governments have opted to keep both central and de-central standard setting in the core ministry (as a policy making task) and not to delegate it to agencies outside of the core ministry. Even if agencies are properly steered by a permanent performance dialogue (see chapter 12), there remains an essential difference between the steering of the core ministry on the basis of frequent interaction with the politically responsible minister and the steering of agencies.

This reasoning is true both at the central (government-wide) level and at the de-central (ministerial) level. Since ministerial support units are typically tasked with de-central standard setting, these units are usually not devolved to agencies. On the other hand, support service units that are not simultaneously tasked with standard setting, including shared service centres, are often devolved into arm's length agencies. Similarly, at the central level, divisions of ministries that support the minister in standard setting are usually kept separate from central support service units, such as shared service centres.

The development of support service units

Next to support service units for the ministry as a whole, many divisions of core ministries traditionally had elementary support service units as well, in particular: financial officers and human resource officers.

In the 1990s, as a consequence of the devolution of policy execution and of supervisory and regulatory tasks to agencies, support service units were also established in agencies. Furthermore, as a consequence of New Public Management, the support service units in the divisions of core ministries were expanded and sometimes evolved

into entire management bureau's under each division or agency head. The division of tasks between the devolved units in agencies and ministerial divisions and the units under the permanent secretary could differ from case to case and was often opaque. In general there was no equivalent reduction in the central units as a consequence of decentralisation, so that total employment in support services increased. Apart from the decentralisation, it also increased autonomously, because standards of operational management were relaxed in the 1990s ("let managers manage", see Chapter 1).

In recent years, as a consequence of a growing concern about the expansion of support service units, both in absolute terms and as a percentage of central government employment, many governments have initiated policies to redress this development. These policies have taken different forms, in particular:

- bringing back support service personnel from ministerial divisions and agencies into single support service directorates under the permanent secretary (intra-ministerial support service sharing);
- sharing of support services between ministries (including their agencies) and between different levels of government (for instance between central government and municipalities);
- targeted personnel reduction exercises, aimed at support services.

The latter policy reduces employment in support service delivery directly, but it also provides an incentive for the implementation of the first and second policies. For instance, if a ministry must realise a target for reduction of support service personnel, it may choose to use to support service unit under the permanent secretary or to use an inter-ministerial shared service centre.

Reforms of this chapter

The current chapter focuses on three reforms:

1. The first is the acceleration of service sharing. This is currently a strong international trend. It contributes to constrain the growth of support personnel employment (and thus leads to savings), but it may also lead to better quality of support services.
2. The second is the integration of standard setting. The background of this reform is that standard setting for all operational means is based on the same basic trade off, namely of service quality against costs. By centralisation of standard setting in a single, or at most a few ministries, the consistency of standards can be enhanced, which can lead to savings.
3. The third is the outsourcing of support services. This reform too, can lead to savings and improvement of quality, but outsourcing also involves risks. These risks have to be taken into account and must lead to strict conditions on what can be outsourced and what have to remain inside government.

Personnel reduction exercises aimed at support services occur in several countries but are not presented in this chapter as separate reform, since they are not a structural measure but a one-off exercise to remedy a development that has gone wrong.

Reform 6.1. Acceleration of service sharing

Characteristics of the reform

The reform consists in acceleration of pooling support services and creating/reinforcing shared service centres that provide support services to more than one ministry (including its agencies) or sub-sectors of government (central government, social security funds, local government). Pooling usually implies transfers of personnel to the shared service units, and staff cutbacks in decentralised units.

The benefits of shared service arrangements are:

- cost savings through concentration, process standardisation, and economies of scale;
- enhancing service quality;
- achieving synergy and facilitating a stimulating working environment for specialists.

Where did it occur?

Shared service centres have been created in many OECD countries. Of the nine participating countries in the Value for Money Study that have provided information about service sharing, two (Australia, Spain) reported that up to now, no shared service centres were in place in their central government. Seven (Austria, Canada, Denmark, Finland, the Netherlands, Norway and Sweden) reported to have established shared service centres. Table 6.1 provides an overview of the number of shared service centres, their total employment and their location (the number of ministries where the centres are located should not be confounded with the number of client ministries and governments to which services are provided).

Table 6.1. Shared Service Centres (SSC)

	Number of SSCs	Total employment	Support services provided by SSC	Number of ministries where the SSCs are located
Austria	6	2 558	IT, procurement, accounting, finance, law, real estate	2 (5 out of 6 in Finance)
Canada	15	11 476 ^a	ICT, procurement, communication, accommodation and facilities, payroll and pensions, learning and training, telecommunications, HR, audit, finance	8 (7 out of 15 in PWGSC ^b)
Denmark	5	n.a.	HR, salary payments, bookkeeping and accounting, payment of pensions, loans and grants, advice on ICT, budgeting, procurement, salary payments, ICT development, accommodation and real estate, pay bargaining.	1 (Finance)
Finland	7	2 087	ICT (2), finance and HR, accommodation and facilities, procurement, training and development	1 (Finance)
Netherlands	25	2 615 ^a	n.a.	4 (17 out of 25 in BZK ^c)

Table 6.1. Shared Service Centres (SSC) (continued)

	Number of SSCs	Total employment	Support services provided by SSC	Number of ministries where the SSCs are located
Norway	4	1 030	ICT, accounting and facilities , procurement, HR training and development , accounting, salaries and travel expenses, switchboard	2 (3 out of 4 in GARCA ^e)
Sweden	2	631 ^f	financial and administrative services	1 (Prime Minister's Office)

Notes: n.a.: not available from the questionnaire responses;

^a Data for some smaller agencies were not available and have not been included;

^b Public Works and Government Services Canada;

^c Ministry of the Interior and Kingdom Relations;

^d Excluding the agencies *Statsbygg* (for accommodation), NCA (for cash collection) and *Brønnøysund* Register Centre (ICT portals);

^e Ministry of Government Administration, Reform and Church Affairs;

^f In persons employed (not in FTEs). This includes both *Kammerkollegiet* (43) and the Office of Administrative Affairs (588). The latter is not known as a shared service centre in Sweden in view of the fact that, since 2007, all ministries have the status of a single agency. However, in terms of the OECD definition, the Office of Administrative Affairs is a shared service centre (it serves more than one ministry).

Source: Responses to Value for Money questionnaire.

Analysis

Two models for the service sharing

There are two distinct models for the creation and use of shared service centres in the countries of the Value for Money study: the top-down model and the bottom-up model. In the top-down model, the use of the shared service centre is imposed and the personnel that provide the support services are transferred from the line ministries to the shared service centre. In the bottom-up model, the use of the shared service centre remains voluntary, but there may be incentives in place to stimulate its use, such as personnel reduction operations (sometimes specified for support services) or automatic productivity dividends cuts (see Reform 6.6). Austria, Denmark and Finland report following a top-down approach. The Netherlands², Norway and Sweden report following a bottom-up approach, while Canada reports using a combination of the two. Table 6.2 provides an overview.

In countries that rely on incentives to stimulate the establishment and use of shared service centres (the bottom-up countries), a more scattered pattern of shared centres is observed. There are no plans in place to move to a more coercive approach, or to concentrate shared service centres in a single ministry. On the contrary it is generally felt in those countries, that the practice of service sharing will increase automatically to the extent that the cost and quality benefits flowing from economies of scale become clear to potential clients. Interlocutors in those countries have also noted that there are risks

attached to the creation of monopoly suppliers of those services within the public sector, particularly as large ICT systems are involved (risks of project failure or malfunctioning of existing systems).

Table 6.2. Incentives, Funding and Efficiency Gains of Shared Services

	Mandatory vs voluntary services	Incentives for use of SSC	Funding of shared services	Collection of efficiency gains
Austria	Mandatory by specific law	One-off savings target	Not available	Cut in appropriation by MoF
Canada	Both	Cost and quality gains for client ministry, <i>ad hoc</i> across the board efficiency cuts	Appropriation (mandatory) and user fees (voluntary)	Agency keeps savings
Denmark	Mandatory by government decision	Permanent cut of productivity dividend (see Reform 7.5)	Cost recovery fees	Cut in appropriation by MoF
Finland	Mandatory by government decision	Permanent cut of productivity dividend specified for support personnel	Cost recovery transfer, negotiated annually	Agency keeps savings
Netherlands	Voluntary ³	<i>Ad hoc</i> efficiency cuts specified for support personnel	Cost recovery transfer, negotiated annually	Agency keeps savings
Norway	Voluntary	One off negotiated budget transfer on the basis of cost recovery	Appropriation	Agency keeps savings
Sweden	Voluntary	Permanent cut of productivity dividend (see Reform 7.5)	Cost recovery transfer, negotiated annually	Agency keeps savings

Source: Responses to Value for Money questionnaire.

Organisation of shared service centres

Shared service centres provide a wide variety of services. Common examples are accounting and invoicing services (in the area of finance), salary and pension payments, recruitment, training, performance assessment, career planning (in the area of human resources and organisation), office automation, development of ICT systems, intranet, government wide portals (in the area of information and ICT), development of standard contracts (in the area of procurement) as well as renting of office space, sale of real estate and moveable property, catering, security, cars, cleaning, printing and telephone (in the area of accommodation, real estate and facilities).

There is no common organisational model of shared services. Most countries have organised the services according to function (e.g. Austria, Denmark and Finland) while some organise services according to user groups (e.g. Sweden and, partly, Canada and Norway). Most countries have organised shared service centres as arms' length agencies, but France has created them inside ministries⁴. The ministerial responsibility for shared service centres also varies among the Value for Money countries, between Ministry of Finance, Ministry of Interior or Administration, and the Prime Minister's Office.

The boxes below provide some examples of inter-ministerial service sharing centres that have been established or reorganised recently in Denmark, France, Finland, and Sweden.

Box 6.1. Denmark

Denmark has adopted a top-down model of service sharing. Shared services are largely concentrated in four agencies of the Ministry of Finance: the Agency for Governmental Management (AGM), the Agency for Governmental Administration (AGA), the Agency for Governmental IT Services and the Palace and Properties Agency. Next to these, there is the State Employers Authority, which supports negotiations with the trade unions for a large number of government employers according to the Scandinavian model of public sector wage setting. AGM and AGA are examples of service centres that provide services in several areas of support services (human resources, organisation, finance, communication, facilities, ICT).

Agency for Governmental Management

The AGM handles human resources and communication services through its Centre for Systems and Personnel (including the budgeting system Navision and the salary payment system SLS); facilities (office, equipment, reproduction, cars, catering, security) through its Centre for Finance and Procurement, and information and IT through its Centre for Digitalisation and Efficiency. In procurement, in particular, the AGM formulates common contracts under the rules and legal framework established by the Ministry of Economic and Business Affairs and the Ministry of Finance. Individual ministries and agencies remain responsible for handling everyday procurement on the basis of common contracts or the EU framework for procurement. Currently, common procurement contracting can only be transferred to the AGM on the basis of agreements with clients. The OECD recommendation with regard to AGM was to make it a central shared service provider in the area of e-government and cross-government digitalisation, without being tasked with standard setting.

Agency for Governmental Administration

The AGA also provides shared services in the area of human resources and organisation. The focus is on personnel administration and salary payment, financial services and administration of state grants, pensions and loans. In the area of financial services the AGA is charged with accounting (for all ministries except justice and defense) and services in the area of budget execution (travel, invoice, loans, grants).

Source: Response to Value for Money questionnaire and update from the Ministry of Finance.

Box 6.2. France

France has developed advanced practices in inter-ministerial service sharing, but has not introduced any formalised and/or systematic mechanism that would encourage the actual transfer of tasks to the shared service centres. Therefore there is no top-down approach in France. The previous policy of the non-renewal of one in two retiring or departing civil servants has been an incentive for ministries to transfer staff to shared services. This measure did not specifically target support services, as the OECD report on France highlights, but significant staff reductions in the support functions have been observed. Currently the main incentive for support service sharing is budget cuts which in principle are equally effective. A National Paymaster's Office (Office national de paye, ONP) described below is an example of a shared service centre.

Box 6.2. France (continued)**Office national de paye (ONP)***

The ONP has been established in 2007 to handle salary payment for all state employees. It is subordinate to both the General Directorate of Public Finance and the Directorate General for Administration and Civil Service. The ONP is intended to be the sole provider of payroll services to the state's employees. It uses the information provided by ministries through special HR information systems. For the employees this reform has facilitated the monitoring of the various components of their remuneration. For the government, it provides more reliable exchange of information between ministries. It also leads to simplification of payroll rules.

Note: *The ONP project is currently (August 2014) in standby. Its ambition and scope are expected to be downsized.

Source: OECD (2012:105).

Box 6.3. Finland

Finland has established shared service centres within the ministries and has followed a similar approach as the Netherlands: the establishment of shared services centres combined with a downsizing operation to provide incentives for task transfer and to assure savings.

The Financial and Personnel Service Centre

The Financial and Personnel Service Centre was established and built up from 2005-2008: It is a merger of the Justice Administration, the Defense Administration, the Interior Administration, the Financial Administration and the University Administration. It provides shared services in the areas of invoicing, accounting, salary payment, personnel administration, ICT and travel administration. It has six regional units apart from the headquarters in Helsinki (after five regional units have been closed in 2010). The centre has a staff of 570 employees. It serves nine ministries and 60 agencies.

IT Management

Another new shared service centre has been established for ICT: IT Management. It started its operation in the beginning of 2009. It is organised as a unit within the State Treasury (a branch of the Ministry of Finance) and has two local units: Helsinki and Lappeenranta, with a staff of 40 employees. Apart from the Financial and Personnel Service Centre and IT Management, shared services centres already existed for procurement (Hansel, a public enterprise; employment 55) and for accommodation (Senate Properties; employment 276 with 13 regional units).

Source: Response to Value for Money questionnaire.

Box 6.4. Sweden

Government agencies in Sweden are expected to choose the most rational and cost-efficient way of managing their business, and are free to make their own choices. It is relatively common for government agencies to rely on external service providers. These normally concern non-strategic functions and are mainly provided by private enterprises.

The Swedish government has one unit that provides shared services to all core ministries, namely the Office of Administrative Affairs under the Prime Minister. It mostly provides services in the sphere of finance, human resources, procurement and ICT.

Furthermore, until recently, Sweden had an administrative service centre within the Legal, Financial and Administrative Services Agency (*Kammarkollegiet*) that provided services to small agencies with less than 50 employees, mostly in the sphere of human resources, such as salary payments.

National Government Service Centre for finance and human resource services

On 1 June 2012 the Government has established the National Government Service Centre to provide support services on a voluntary basis within three areas: finance and accounting, payroll management, and e-commerce. The agency is financed by user fees with the requirement of full recovery of all costs. The agencies therefore are in principle free to choose whether to use the services of the new service centre or not. However, agencies deciding not to use the service centre have to demonstrate that they produce or acquire the services concerned in a way that it is at least as efficient as having them delivered by the service centre.

On 1 October 2012 *Kammarkollegiet* has been integrated within the Service Centre. The Government's motive of incorporating *Kammarkollegiet* within the Service Centre is holding down the government administration's overall IT costs and ensuring that the government's administrative support activities as a whole are developed based on common goals and aspirations. At 1 July 2012, seven agencies were customers of the Service Centre, which amounts to more than 12% of the government administration as measured by number of government employees. In addition, on 1 October 2012, the agencies who were customers of the *Kammarkollegiet* became customer agencies to the Service Centre, which represents approximately 2% of government.

Source: Response to Value for Money questionnaire and update from the Ministry of Health and Social Affairs.

Financing and steering

It is important that the ministry which owns the centre remains fully accountable for its operational management and efficiency. This can only be achieved if the financing relation with the centre remains firmly in the hands of the owner ministry. Whereas it is appropriate that the client ministries and agencies communicate regularly with the unit or centre about the modalities of service delivery in a permanent performance dialogue, it is important that the ministry that owns the unit or centre is exclusively responsible for its financing. This is the only way that accountability for the efficiency of the unit centre can be made effective. The client ministries and agencies of the unit or centre can be made to “pay” for the services provided by shared process units or service centres by inter-ministerial reallocation of the resources concerned. This will be reflected in the reduction of the line items from which the resources are taken (usually operational expenditures of core ministries).

The owner ministry is not only responsible for the financing and operational management of the shared service centre but also for the effectiveness of the permanent performance dialogue between the client agencies and the management of the service centre (see Reforms 12.1 and 12.2). In particular, the owner ministry should make sure that the client agencies are represented in the team that conducts the performance dialogue and diverging interests among the clients are reconciled before the dialogue starts.

Sharing services may be seen as a first step towards outsourcing to private service providers or privatisation of shared service centres (See Reform 6.3).

Feasibility of the reform

The service sharing initiative has to be driven by considerations of efficiency, service quality (large support units can develop more expertise in specific areas, that is sought by clients and offer better career opportunities to staff) and competitive advantage vis-à-vis the private sector (large support units provide a better environment for career development by specialists). An additional incentive is the possibility to release resources for the ministries' or agencies' core activities.

When taking steps towards the use (or increased use) of shared service providers, government should consider which approach (top-down or bottom-up) would be the best to harvest the benefits of service sharing. The voluntarily model (bottom-up), based on logic of maintaining a sort of market within government, appears to be a good and safer starting point for accelerating service sharing. A strong central push (top-down approach) on ministries and agencies can be a final model and would particularly fit in times of austerity.

Reform 6.2. Concentration of standard setting units for operational management

Characteristics of the reform

In many OECD countries the setting of government wide standards for operational management is dispersed between several ministries (when, for example, the Ministry of Finance sets standards for finance and internal audit, the Ministry of Interior or Public Administration for human resources, organisation, ICT and facilities, the Ministry of Economic Affairs for procurement, the Ministry of Housing for accommodation and real estate). The reform consists in concentration of standard setting in one ministry, preferably the Ministry of Finance, or in a few ministries.

The reform focuses on operational management in core ministries and agencies (both arm's length and independent agencies) that do administrative work. Agencies that provide services in kind (police, schools, hospitals, penitentiary services, armed forces, natural conservation agencies, infrastructure construction agencies, etc.) require special standards for operational means. Therefore government-wide standards (in so far as applicable to non-administrative work) are generally complemented by agency-specific standards that necessarily must be set by the line ministries. Apart from agency-specific standards, there may also be a need for ministerial standards for administrative work to complement government-wide standards, in view of specific circumstances of the ministry. These standards too, must necessarily be set by the line ministries.

Where did it occur?

All OECD countries have general rules and policies relating to many areas of operational management in order to safeguard quality standards in operational means, as well as to control costs. Many OECD countries are now attempting to regain control over the use of operational means in executive agencies (which employ on average 75% of administrative employment in the countries participating in the OECD Value for Money study, see Chapter 2).

Among some countries participating in the Value for Money study there is currently a tendency to concentrate standard setting in a single or a few ministries for all operational means. France and Denmark have gone so far as concentrating almost all standard setting for operational management in the Ministry of Finance. This ministry is seen as the best location for standard setting, since the balancing of service levels and quality against costs is the core task of this ministry. In many OECD countries, however, this is currently not the case. Several countries are considering moves in the direction of concentration, but since this involves the politically sensitive reallocation of responsibilities between ministries it is generally a difficult process.

Analysis

Concentration of standard setting in one or a few ministries

The underlying idea of standard setting is to strike a proper balance between “letting managers manage” and preventing excessive use of operational means. Government-wide standard setting should be stricter in areas where divergence in ministerial standards might lead to unnecessary diversity and additional costs. It helps ensure universal practices, better transparency, use of best practices and less discretionary decisions. Moreover standard setting allows safeguarding quality in operational management and costs control. Since the trade-off between service quality and cost control is a key task and area of expertise of the Ministry of Finance, the concentration of government-wide standard setting in that ministry is often seen as the best solution.

These considerations lead to the following conclusions:

- Government-wide standard setting should be stricter in areas where divergence in ministerial standards might lead to unnecessary diversity and additional costs.
- It is important that government-wide standards are set in the core of a central ministry under the supervision of the minister while ministerial standards are set in the core line ministries under the direct supervision of the line minister.
- To provide consistency in standard setting, it is also important that support service units are placed in core ministries if they simultaneously carry out central or de-central standard-setting tasks (not in arm’s-length agencies).
- Support service units, whether in core ministries or in agencies should not be tasked with tasks in the sphere of the primary process for which they provide support.

France

The French central government has always been characterised by strict central rules for the use of operational means. This is particularly true for human resources, where

rules on recruitment and pay are particularly strict. In other areas such as finance, accommodation and procurement, strict rules for the whole of central government have always been in place as well.

Although government-wide standard setting used to be scattered over various ministries as in other OECD countries, in France the concentration has already taken place in the Ministry of Budget, Public Accounts and Reform of the State, although management of the civil service was recently split off to a separate ministry. This recent change has led to the creation of two standard setting ministries: the Ministry of the Economy and Finance and the Ministry of the Reform, Decentralisation and Civil Service.

Table 6.3. Government-wide standard setting in France

	Government wide standard setting	Ministry
Communication	Government Information Service	The Prime Minister
Human resources and organisation	General Directorate of Administration and the Civil Service (<i>La Direction générale de l'administration et de la fonction publique</i> , DGAFP)	Under joint authority of the Prime Minister and the Minister of Civil Service (Ministry of the Reform, Decentralisation and Civil Service)
Internal audit	Finance Inspection (<i>Inspection générale des finances</i>) The Committee for Harmonisation of Internal Audit (<i>Le Comité d'harmonisation de l'audit interne</i>)	Ministry of the Economy and Finance Ministry of the Reform, Decentralisation and Civil Service
Procurement	Procurement Service of the State (<i>Service des achats de l'État</i>)	Ministry of the Economy and Finance
Finance budgeting	Budget Direction (<i>Direction du budget</i>)	Ministry of the Economy and Finance
Finance accounting and cash and debt operations	Department of Public Finance (<i>Direction générale des finances publiques</i> , DGFîP)	Ministry of the Economy and Finance
Accommodation and Real Estate	France Domaine, DGFîP	Ministry of the Economy and Finance
Facilities (office equipment, reproduction, cars, catering, security)	Procurement Service of the State (<i>Service des achats de l'État</i>)	Ministry of the Economy and Finance
Information and ICT	The interdepartmental Direction of information and communication systems of the State (<i>Direction interministérielle des systèmes d'information et de communication de l'État</i>)	The Prime Minister

Sources: OECD 2012, Response to Value for Money questionnaire.

Denmark

Denmark has made significant progress in the development of standard setting and shared service centres. Shared services are largely concentrated in four agencies of the Ministry of Finance: the Agency for Governmental Management, the Agency for Governmental Administration, the Agency for Governmental IT Services, and the Palaces and Properties Agency. Alongside these is the State Employer's Authority, which supports negotiations with the trade unions for a large number of government employers according to the Nordic model of public sector wage setting (see Reform 8.3). However, whereas in Denmark government-wide standard setting is currently concentrated to a large extent in the Ministry of Finance, it is often entirely or partly tasked to agencies rather than to a central unit for operational management in the core ministry. Table 6.4 below provides a survey of the current set-up of standard setting in Denmark.

Table 6.4. Government wide standard setting in Denmark

	Government-wide standard setting	Ministry
Communication	-	
Human resources and organisation	State Employer's Authority	Ministry of Finance
Internal audit	National Auditor (= external auditor)	Not a ministry
Procurement	Centre for Finance and Procurement of the Agency for Governmental Management	Ministry of Finance
Finance budgeting	Centre for Finance and Procurement of the Agency for Governmental Management	Ministry of Finance
Finance accounting	Centre for Finance and Procurement of the Agency for Governmental Management	Ministry of Finance
Finance cash and debt operations	Treasury (part of the core ministry)	Ministry of Finance
Accommodation	Palaces and Properties Agency	Ministry of Finance
Real estate	Palaces and Properties Agency	Ministry of Finance
Facilities (office equipment, reproduction, cars, catering, security, etc.)	Centre for Finance and Procurement of the Agency for Governmental Management (office equipment)	Ministry of Finance
Information and ICT	Centre for Digitalisation and Efficiency of the Agency for Governmental Management Agency for Governmental ICT Services	Ministry of Finance

Sources: OECD 2011, Response to Value for Money questionnaire.

Feasibility of the reform

This reform can be combined with other ongoing reforms in view of austerity programmes. For instance, service sharing is now high on the political agenda of all OECD countries (see Reform 6.1). Therefore, it is a good opportunity to develop new policies for the whole area of operational management, including standard setting. Concentration of standard setting and tasking it to one or a few ministries is an essential component of such new policies. Since this concentration involves politically sensitive reordering of tasks between ministries, the most favourable time to decide such reordering is at the occasion of the cabinet formation, when a new government is formed and tasks shifts between ministries are decided more generally.

Reform 6.3. Outsourcing of support services

Characteristics of the reform

Outsourcing of support services means devolving these services (finance, human resources, ICT, accommodation and facilities, procurement, etc.) to private or public companies with the aim to achieve more efficiency and service quality. Efficiency and quality will be enhanced by market incentives (competition and the profit motive). Outsourcing can provide for substantial savings.

Where did it occur?

Outsourcing is a practice used by many OECD countries to different extents. Outsourcing of support services is in the UK part of a more general policy of outsourcing of intermediate production. The UK has in many expenditure areas a high rate of outsourcing (general government expenditures divided by intermediate production (see Chapter 2). The value of such contracts in the UK has risen from GBP 9.6 billion in 2008 to GBP 20.4 billion in 2012. Seymour Pierce⁵ estimates that public sector outsourcing could hit GBP 10 billion by 2014-15⁶.

Analysis

Outsourcing transactional⁷ services in the UK

The UK is one of the most advanced countries as far as outsourcing of support services is concerned. Since 2004 the UK Government has created incentives for public institutions (at both the central and the local levels and both internally and across departments) to pool similar services that are easy to share with the aim to deliver more for less. These services include back office functions, such as payroll, human resources, ICT and finance. The benefits of shared services arrangements include reducing unnecessary duplication of overheads in separate public institutions; achieving economies of scale; and getting more consistent, more specialised and thus more professional services.

The outsourcing in the UK gained momentum with a policy of Open Public Services set out in the 2011 White Paper (see Box 6.5).

Box 6.5. Open Public Services in the UK

The aim of the new Open Public Services policy is to provide people with the best possible services for the money spent. The White Paper presented to Parliament by the Minister for Government Policy in 2011 set out principles for reforming public services and established a comprehensive policy framework across public services for the next few years. The Paper established principles of Open Public Services:

- Choice: giving people direct control over the services they use. Where direct control is not possible, giving more choice about who provides services and how.
- Decentralisation: decentralising power to the lowest appropriate level.
- Diversity: wherever possible, opening public services to a range of providers competing to offer a better service.

Box 6.5. Open Public Services in the UK (*continued*)

- Fairness: ensuring fair access to public services (to advantage the disadvantaged and improve their outcomes).
- Accountability: holding Open Public Services responsive to the people they serve and accountable to citizens and their elected representatives.

The White Paper distinguishes individual (personal services used by people on an individual basis), neighbourhood (services provided locally and on a collective basis) and commissioned services (local and national services that cannot be devolved to individuals or communities, such as tax collection, prisons, emergency healthcare or welfare to work).

In the services amenable to commissioning, the principle of Open Public Services switches the default from one where the state provides the service itself to one where the state commissions the service from a range of diverse providers (see Reform 4.4).

The White Paper introduces an “open commissioning” policy in a number of specific services. In those areas where it can be introduced, commissioners should: consult on and be challenged by potential providers from all sectors on the future shape of service; seek and fully consider a minimum of three providers, from whichever sector, when they contract for services; and transparently link payment to results. Open commissioning and payment by results are critical to Open Public Services.

Source: Response to Value for Money questionnaire and update from the Cabinet Office.

Ministries, agencies and other public institutions were encouraged, through the Cabinet Office, to establish their own shared services centres. By 2012 eight major centres have been established to provide back office functions to their sponsoring government ministries (the Ministry of Justice, the Ministry of Defence, the Ministry for Transport, the Ministry for Environment, Food and Rural Affairs and the Ministry for Work and Pensions, Home Office, Cabinet Office, the Ministry of Education and some other ministries) as well as those of some of their associated agencies.

With the 2012 Civil Service Reform Plan the development of shared services arrangements has gained new momentum. The programme is making use of a variety of delivery models: outsourcing, joint venture and strategic partnership with a range of suppliers and platforms and implies creating five centres for support services, creating the necessary infrastructure by the end of 2013, with full delivery of the programme by July 2015 (see Box 6.6). Potential savings from consolidating these services into five shared centres are expected to be between GBP 400 million and GBP 600 million a year through reaching upper quartile efficiency levels⁸.

Box 6.6. UK Next Generation Shared Services Programme

The 2012 Civil Service Reform Plan of Next Generation Shared Services (NGSS) implies creating five centres for transactional services:

- Independent Shared Service Centre 1 (ISSC1) that will serve smaller ministries (eight ministries at the central level) and has the following features:
 - Based on an existing ministerial shared service centre.
 - Outsourced to Private Sector and managed centrally through Cabinet Office. It operates on the basis of a contract between the Cabinet Office and a private company. The contract is concluded for management of services whilst the ownership of the centre remains with the Government.
 - The fees for services are established in the contract after negotiations between the Cabinet Office and the service provider.
 - Has a special Enterprise Resource Planning solution (Agresso).
- Independent Shared Service Centre 2 (ISSC2) will serve five larger ministries is characterised by the following:

Source: Response to the Value for Money questionnaire and update from the Cabinet Office.

HR management and outsourcing

The transfer of support services from the public to the private sector is a politically agreed policy aim in a number of countries in the post-crisis environment. A key concern and a topic of public criticism in this respect is what happens to staff when activities are transferred to the private sector. How staff can be retained when their jobs are moved? How should the change of status be compensated? How can staff be motivated to cooperate and how can a more flexible transition be ensured?

An OECD study (OECD, 2005) shows that after outsourcing government employees are often transferred to the private provider with their working conditions temporarily guaranteed and that in some OECD member countries there is specific legislation in place for such situations. In the European Union there has also been issued a directive for this transition. Some governments (e.g. Australia) have developed policies and guidelines for managing some aspects of outsourcing such as negotiation with unions and a “clean break” approach versus a transfer of employees.

Challenges of outsourcing

There are certain risks related to outsourcing. In the literature on institutional economics, “specific assets” are sometimes mentioned as an important argument against outsourcing. If private sector firms have to develop tailor made services for the public sector, they obtain a monopoly position vis-à-vis the government allowing them to charge prices above costs. In addition public service provision becomes vulnerable to quality deficiencies in private supply chains. These factors should be taken in consideration when implementing the reform.

To mitigate these risks the UK Government has focused its outsourcing policy for support services only on transactional services; removed discretion in applying standards; made the choice of outsourcing more flexible by introducing core and optional services; fostered market competition; and implemented a system of Crown Oversight Management when boards including representatives of different departments and of the

Cabinet can oversee the activities and results of shared service centres. In addition, the Government has required from departments to meet upper quartile performance.

Feasibility of the reform

The implementation of this reform requires careful preparation and a strategic approach. The most challenging aspect is that outsourcing implies difficult and sensitive decisions with regard to public employees (redeployment, change of status and of labour conditions). Experience shows that outsourcing requires significant in-house investments in specialised staff to manage and supervise the outsourced contracts. There is a risk that unless outsourcing is accompanied by concomitant changes in public employment and rigorous monitoring of contracts, it may increase production costs rather than producing efficiency gains, and lead to a decrease in service quality (OECD, 2011).

Another factor to be considered when implementing the reform is that outsourcing should imply changes in the public institutions being served. Failing to simplify and streamline functions within these institutions prevents the realisation of the real benefits of outsourcing. Unnecessary duplication occurs when ministries retain too large in-house staff to oversee the functions which are transferred to a contracted provider. For shared services centres it means that they should not be too small (serving only a single small ministry) and that, as long as the use of the shared service centre remains voluntary, capacity should be planned on the basis of actual demand and not on the basis of assumptions about potential demand (see Reform 6.1).

Notes

1. For instance the ministerial finance directorate may provide support to the ministerial human resource directorate, etc.
2. Since the questionnaire for the Value for Money study has been answered, the Netherlands has moved to a more coercive approach that can be seen as a form of the top-down model.
3. See previous footnote.
4. Information about France was retrieved from OECD, 2012 (France participated in the Value for Money study but mostly provided information in the context of the public management review of France that took place simultaneously).
5. See more at <http://www.seymourpierce.com/>.
6. Willams Z., *“This obsession with outsourcing public services has created a shadow state”*, the Guardian, 7 February 2013.
7. “Transactional” refers to customer-facing services and their related back-office support services.
8. Upper quartile efficiency levels are measured on the basis of a benchmark developed for the Government by a private company APQC that specialises in shared services. The benchmark reflects the best value a public institution can achieve in managing its back office services.
9. The “Clean Break” approach in Australia does not involve any negotiation of jobs and terms and conditions of employment by the outsourcing agency with the new service provider. The new service provider is free to enter negotiations with affected employees regarding employment opportunities.

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Chapter 7

Financial management

In this study finance is conceived as a support service, comparable to human resources, procurement, etc. This conception implies that sectoral policy has priority over budgetary policy and that the budget process must serve the policy process in the best possible way.

In the era of New Public Management, the budget process was sometimes seen as the principal policy making process in government, of which all sectoral policy depended. This led to a large extension of the task package of the Ministry of Finance at the expense of the line ministries. This conception of the budgeting process is gradually becoming less prominent or sometimes even abandoned implicitly or explicitly. In connection with this development there is a renewed focus on the classical functions of the budget, namely those of authorisation, macro-economic steering, allocation and operational control.

In the area of authorisation, parliamentarians and the public put more emphasis on transparency, which has consequences for reporting on current and new spending. In the area of macro-economic steering, more and more countries are adopting medium term expenditure frameworks (MTEFs) and are trying to keep them fixed from year to year. Some countries have introduced spending review procedures to support the decisions on the expenditure framework. As far as allocation is concerned many countries have reformed the budget classification, defined the line items mostly by programmes, and reduced the number of line items to 10-15 per ministry. As far as operational management is concerned the most important innovation is the introduction of automatic productivity cuts. The reforms presented in this chapter consist of best practice examples in each of these areas.

Introduction

Finance as a support service

In this study finance (including budgeting, accounting and cash and debt operations) is conceived as a support service, comparable to human resources and organisation, procurement, information and ICT, etc. This conception is not always seen as evident and it is useful to pay attention to the reasoning behind it.

In the era of New Public Management, budgeting was sometimes seen as the principal policy making process in government, of which all sectoral policy making depended. This led for instance to the conclusion that sectoral policies had mainly to be decided in the context of the budget process and that the Minister of Finance was responsible for reporting on sectoral policy results and taking action as sectoral policies did not have the expected results. This view had profound consequences for Ministries of Finance. Expenditure divisions were henceforth expected to assess the adequacy of performance indicators or even to take the lead in the development of such indicators, and they were supposed to analyse sectoral policies and come up with remedies if these policies were deficient. Obviously this led to an enormous expansion of the task package of the Ministries of Finance that they were often unable to handle.

In the Value for Money study, it has come to light that this conception of the budgeting process is gradually becoming less prominent, or sometimes even abandoned implicitly or explicitly. This seems a return to the past when the task of the Ministry of Finance was seen as one of recording the consequences of sectoral policies and when the emphasis of the work both in Ministries of Finance and in the finance divisions of line ministries was more on accounting than on budgeting. However, in other aspects of budgeting, there is no return to the past as the budgeting process in most central governments has become more complex and as important innovations have changed it beyond recognition over previous decades. Furthermore, the relation to sectoral planning is an important conceptual question that has consequences for the institutional design of the budget process.

The trend to focus the budget process on financial support and to leave sectoral policy making and execution to the line ministries and the government as a whole has two main consequences for the institutional design of the budget process: 1) sectoral policy has priority over budgetary policy, and 2) sectoral policy making cannot be forced into the requirements of the annual budget cycle and should be allowed to follow its own cycle of development, implementation and evaluation.

The priority of sectoral policy making

A large majority of OECD countries have over the last decade moved to a budget procedure based on Medium Term Expenditure Frameworks (MTEF's). The main advantages of such frameworks are that expenditure ceilings provide a stable framework for sectoral policy making, that they imply top-down budgetary decision-making as opposed to the incremental budgeting procedures prevailing in the past and that they may contribute to automatic macro-economic stabilisation, in particular if the frameworks are fixed (not adjustable from year to year) and for a relatively long period (3 or 4 years). However, countries that have moved to a framework procedure have not always taken into account that the institutional design of the resulting budget process has to respect the priority of sectoral policy making. Since expenditure frameworks have profound consequences for sectoral policies, it is important to take the requirements of sectoral

policy making into account on penalty of the collapse of the frameworks at the first occasion that they clash with the demands of the latter. Unfortunately this has often happened, although the overrun of expenditures ceilings was for understandable reasons not always loudly proclaimed in the countries where it occurred.

If a country introduces an expenditure framework, it is important that this does not imply that line ministries are denied the opportunity to make request for resources to finance new policies. In other words, top-down budgeting, essential as it is, must not mean that line ministries can only ask for resources to finance new policies when it is too late, namely after their expenditure ceiling has been set. It must also not mean that henceforth they can only finance new policy initiatives if they provide compensation by reducing resources for current policy. Such implications would be irrational from the point of view of allocation and not resistant against the needs of political practice. Indeed, it belongs to the essence of budgeting since the French revolution, recognised in the principles of universalism and unity, that all expenditures are in the budget and that all trade-offs can be made between alternative spending options, regardless whether they resort under the same ministry, as well as between spending and tax relief. This implies that spending ceilings, both the overall ceiling and the ministerial ceilings can only be set after:

1. spending requests by line ministries have been made and savings options on current policies have been considered;
2. updated estimates of spending for current policies (baseline estimates) have become available;
3. tax receipts under existing legislation have become available;
4. a fiscal rule or objective for fiscal policy in the medium term to anchor the framework has been established; and
5. options for tax changes have been considered.

If the budget year coincides with the calendar year and the expenditure framework is set before the summer, this means a forward shift of the budget calendar with a few months.

The priority of sectoral policy making also implies that decision-making about sectoral policies cannot be forced into the alleged requirements of the annual budget cycle. In practice of course, it has never been in any country. Sectoral policies have their own cycle. They are developed, decided, implemented, evaluated and revised in response to the needs of each sector. Procurement of weapon systems for defence has a very long cycle of some ten years or more (fighter planes, navy ships) and so has road construction. Other policies have shorter cycles such as public housing or health care or education. For many sectoral policies it is also true that they are decided *ad hoc* in response to major events, for instance prison security if a dangerous criminal escapes, or dyke construction in case of flooding, or, for that matter, participation in bank shares if a major bank needs to be rescued. For the budget process this implies that budgets need to be flexible once they are adopted. Ministers must be able to reallocate resources within their portfolio by reordering of baselines, and as far as the current budget year is concerned by reordering appropriations within their ceilings, if necessary by supplementary budget laws, or ultimately by demanding reordering of their ceilings within the overall ceiling to be brokered by the Prime Minister. Attempts to introduce rigidities in the budget process that

are not adapted to these exigencies of sectoral policy making are bound to fail, as experience in many OECD countries has shown.

New focus of financial management

The fact that in many countries fiscal policy is withdrawing from the area of sectoral policy does not mean that it has become less important. On the contrary, the current emphasis on in-kind service delivery, coinciding, for that matter, with the need for austerity occasioned by the global financial crisis and low GDP growth in many OECD countries, has led to numerous innovations and reforms, that have contributed to the relevance of the budget process, rather than diminishing it. However, it is characteristic of these innovations and reforms that they focus again on the basic roles of the budget as a tool of financial management, rather than as a tool of governmental policy making in general. These basic roles have not fundamentally changed over the previous decades and are recognised in every handbook on public finance. They include the “functions” of authorisation, macro-economic steering, allocation and operational control.

As far as authorisation is concerned there is a new emphasis on transparency. Parliament and the public at large must be able to understand what the implications of the budget are. This means among other things more emphasis on baseline reporting. Parliament must be informed about the changes in baselines both at the occasion of establishment of the expenditure framework and at the occasion of submission of the budget and of supplementary budgets. Which baselines have been increased or decreased? What are the underlying decisions on sectoral policies: which new policies are being financed, which cuts in existing policies have been decided? Parliament must also be able to understand the increase and decrease of baselines in the out-years after the budget year. What factors make policies more or less expensive in future years. Finally, it must be able to understand why baselines have changes since the previous (supplementary) budget: have any sectoral policies been changed or are changes based on updated estimates of the costs of current policies (windfalls and setbacks originating in unexpected demand for services or cost decreases or increasing in services). The reform on baselines (Reform 7.2) and the reform on the budget documentation (Reform 7.4) of this chapter describe recent innovations concerning transparency.

As far as macro-economic steering is concerned, the move towards expenditure frameworks is the most conspicuous trend in almost all OECD countries. Practices concerning such frameworks come in a large variety. They can be flexible or fixed (adjustable from year to year or non-adjustable). If they are fixed they can be fixed for a relatively short period (two years) or a relatively long period (three or four years). They can contain new spending or savings proposals for the out-years or not. Reform 7.3 describes these varieties as they are practiced in a number of OECD countries that are on the forefront of innovation in this area.

Furthermore the setting of expenditure frameworks can be supported by the development of savings options in spending review procedures. The need for such procedures stems from the fundamental asymmetry of the budget process. Line ministries have incentives to propose new spending proposals of high quality, because quality contributes to the chance of adoption. For the same reason however, they have little incentives to propose saving proposals of high quality, at least as long as the expenditure framework is not adopted. Therefore a number of countries has organised the exploration of savings options outside the regular budget process in special spending review procedures. Reform 7.6 describes these procedures.

As far as the function of allocation is concerned, the most important innovation is the programme classification of the budget. Many countries have revised the budget classification in terms of programmes or policy areas, which are characterised as bundles of policy instruments (grants, subsidies, social benefits, investments, etc.) with the same policy objective. This reclassification has often drastically reduced the number of line items (separate appropriations subject to parliamentary authorisation) of the budget, from many thousands of items to a few hundred. Introduction of a programme classification has sometimes already taken place in the 1990s or in the early 2000s as part of New Public Management agenda. In that period a programme classification was thought to be an essential ingredient of “performance budgeting” and more focus on results. However, apart from that aspect, a programme classification is an important prerequisite for focusing the budget debate on allocation and political priorities. It is therefore understandable that no country has gone back to a classification based on inputs, now the emphasis on performance and results has shifted from the budget process towards the sectoral policy process. Reform 7.1 describes the programme classification and the pitfalls and remedies associated with it.

Finally, as far as operational control is concerned, the most important innovation comes to the light in this study, concerns automatic cuts of productivity dividends. The scrutiny of the efficiency of government operations is recognised as a task of the Ministry of Finance in the Budget Code of most OECD countries. However, Ministries of Finance have always been struggling with the question how to perform this task in an effective way. It often came down to advising the Minister of Finance on possible efficiency gains at the occasion of new spending initiatives of line ministries or at occasions when savings had to be inventoried. There are no good examples of systematic scrutiny of current spending programmes. Spending review (Reform 7.6) is a part of the solution. In countries where spending review has been institutionalised, these reviews typically not only look at options for savings by cutting current service levels, but also at savings options by more efficiency. This can imply using other policy instruments (allocational efficiency) or reducing the costs of current instruments (operational efficiency). This can mean for instance stricter eligibility rules or increasing private contributions, so that social services become more focused on low income households, or it can mean performing government tasks in the areas of administration or in-kind service delivery at lower costs. Automatic cuts of productivity dividends are another means to perform this function. There are several OECD countries that have institutionalised this reform. This is not an easy reform, and there are many precautions that have to be taken in order to implement it in a successful way. Reform 7.6 describes this institutional change in the countries where it occurred and analyses the experiences thus far.

Reform 7.1. Programme classification of the budget

Characteristics of the reform

This reform consists in reclassifying the central government budget according to programmes (or policy areas) in order to focus more on results of public expenditures. A programme – based classification allows more result-oriented decision-making process and a better assessment of trade-offs between expenditures for different policy areas and between expenditures and revenues.

Frequently occurring features of a programme classification are:

- a limited number of line items (not more than 500);
- breakdown by expenditure groups or programmes;
- multi-annual baseline estimates provided in the same classification;
- a separate single line item for each line ministry for current operational expenditure of the core ministry and for each agency under the ministry (compensation of employees plus intermediate consumption).

Where did it occur?

In the last two decades, a number of OECD countries have reclassified their central government budget for the purpose of authorisation: Australia, Canada, Finland, France, the Netherlands and Sweden offer good examples of reclassified budgets based on programmatic criteria.

The number of line items in the classifications of the countries that have implemented this reform ranges from 100 to 500. In 2007 the programme-based budget classification of Australia included 175 line items, of Canada 200 line items, of Finland 476 line items, of France 130 line items¹, of the Netherlands 200 line items² and of Sweden 500 line items (OECD, 2013).

Analysis

The classification design

The reform focuses on the classification that is used for the authorisation of the budget in appropriations laws and defines the line items of the budget.³ Each country can only have a single line items classification that is typically based on a mixture of institutional⁴, economic⁵ and functional⁶ criteria.

A line-item classification is programmatic if it is based on outputs: goods and services in kind produced, cash transfers delivered and regulations executed. A programmatic classification is considered to be more supportive of the allocative, macroeconomic and managerial functions of the budget than a classification which is based on inputs. These are the advantages:

- Considering that programmatic line items are characterised by related objectives (“outcome” targets) or even a single ultimate objective of all expenditures financed by the line item, a programmatic classification is more supportive of the allocative (priority-setting) function of the budget.
- As to the macroeconomic function of the budget, the programmatic classification improves the steering of total expenditures and the maintenance of budget discipline. This requires however that line items not only contain estimates for the budget year but also estimates for the medium term: estimates for two, three or four years after the budget year. Steering of total expenditures necessarily requires a multi-annual perspective so that future problems can be timely identified and addressed. Multi-annual estimates are usually not authorised and have no legal status but are important for macro-budgetary planning. A programmatic line-item classification is important for the development of reliable multi-annual estimates because such estimates have to take into account the future

demand for outputs. Multi-annual estimates that do not take future outputs into account can only result from a mechanical extrapolation of the trends in input costs and will be intrinsically unreliable.

- A programmatic classification is also more supportive of the operational control function of the budget, which refers to the steering of the budget towards optimal operational efficiency (minimal costs per output). This is the case because the programmatic classification is based on policy area (groups of outputs). It stimulates the analysis of cost structures of production units such as hospitals, educational establishments or courts through comparisons over time (longitudinal comparisons) or across different regions (cross-sectional comparisons). This allows the steering of the budget towards minimal costs per output.

Reclassification according to output areas or programmes generally leads to a reduction of the number of line items. Since ministries are generally responsible for 5 to 20 programmes, and since the number of ministries ranges from 10 to 25, the number of line items in a programmatic classification ranges from 100 to 500.

With regard to the organisational structure of ministries and the division of tasks between ministries in the process of reclassification, it is advisable to stay as close as possible to existing organisational structures. If necessary the organisational structure should be changed first so that every Director General is made responsible for related programme line items and no overlapping responsibilities arise. Directors-General are thus made responsible for results as well as budgetary discipline for (each of) the programme(s) assigned to them. Overlapping responsibilities, in the sense that several Directors-General are responsible for the same programmes, inevitably lead to problems. Even more problematic are overlapping responsibilities between different line ministries. Therefore it is important to avoid such overlapping.

The relaxation of input control

Moving towards a programmatic line-item classification leads by definition to a certain relaxation of input controls and may thus be seen by the Ministry of Finance as a risky enterprise. Inputs are conceived in this connection as expenditures split according to the economic classification: compensation of employees, intermediate consumption, gross capital formation, etc. The ministry tends to put strict constraints on moves in this direction. Two basic conditions are:

- Budget estimates and multi-annual estimates should be well explained, preferably in terms of outputs and cost per unit.
- Strict rules of budgetary discipline should be put in place to guarantee that overspending on ministerial ceilings cannot occur.

Up to date and reliable baseline estimates (see Reform 7.2) is a necessary prerequisite of programme budgeting. The first condition mentioned above requires that these line-item estimates were well explained. Explanations in terms of outputs and costs per unit make it possible for the Ministry of Finance and Parliament to shift attention from inputs to outputs in the exercise of their supervisory tasks. It is necessary to limit these explanations to a rough summary of the actual financing rules, which allows the users (Ministry of Finance, Parliament, the public) to assess the plausibility and acceptability of the estimates. In any case, explanations of demand and price of outputs should reflect the financing rules actually used to finance the ministerial divisions and agencies that

produce the outputs. It should be kept in mind that the essential aspect of programme budgeting is the discretionary authority of line ministers and budget holders over resources, in particular the possibility to shift resources between inputs. If outputs are not used to finance the divisions and agencies that produce the services and line items have to be explained in terms of inputs, it may be discovered at the end of the budget year that resources were used differently than described in the explanation of the line item in the budget documentation. That should not be a problem as long as the actual use of the resources is accounted for in the financial report of the budget year. Even in the case of input explanations, the programme classification can fulfil its role of allowing discretion to line ministries, without impairing the supervisory tasks of the Ministry of Finance and Parliament.

The second condition requires that line ministries accept the responsibility of not overspending their budgets. This is perhaps the most important message that must be communicated to everybody involved in the reclassification exercise: a programme classification is a contract between the Ministry of Finance and the line ministries in which discretion over inputs is exchanged for the acceptance of rules of budgetary discipline. This is not to say that, under a programme classification, reallocation of resources between line items should no longer be allowed. Even though the need for reallocation will automatically decrease when separate line items cover a larger part of ministerial resources, there will still be a need for reallocation between line items (programmes) in order to react to new circumstances, a change of political priorities or unexpected developments in the demand for services. This is true for the budget estimates, once they have been enacted in the budget laws, but even more so for the multi-annual estimates which cover a more distant and therefore more uncertain future. However, these reallocations should be subject to a strict regime of budgetary discipline that goes beyond the simple requirement that reallocations should be approved by the Ministry of Finance or authorised in supplementary budget laws. In particular, reallocations need to comply with compensation rules which raise high barriers against overspending on ministerial budgets.

Authorisation of administrative expenditure

A particular matter of concern for the Ministry of Finance and Parliament is the authorisation of administrative expenditures⁷ of line ministries. These expenditures include the salaries of staff, and the procurement costs of goods and services of administrative units of core ministries and administrative agencies. A risk attached to the introduction of programme budgeting is that resources intended for subsidies to the private sector, cash transfers to citizens, and grants to local governments will instead be used for the recruitment of additional administrative staff, improvement of office buildings, etc. Even if strict rules of budgetary discipline have been put in place, this perceived risk may cause hesitations or resistance against the introduction of programme budgeting on the side of the Ministry of Finance and Parliament.

The risk of shifting resources from programme budgets to administrative budgets is compounded by the problem of splitting administrative expenditures into programme areas. For this reason, some governments (e.g. the Netherlands, Sweden, the United Kingdom) that have moved to a programme classification have maintained separate line items for administrative budgets (implying that current operational expenditures⁸ of administrative units are not broken down by programmes). Administrative budgets usually represent only a small part of the overall budget (less than 10%). Keeping a separate line for administrative expenditures in each ministerial budget does not mean

that ministers cannot reprioritise spending within this budget (for instance spend more on staff at the expense of procurement of goods and service) but that they cannot increase the administrative budget by moving programme resources (subsidies, cash transfers, grants, etc.) into administrative budgets.

In view of the previous considerations, a stylised format for a programme classification of a line ministry's budget could look like the example in the table below.

Table 7.1. Stylised budget classification

	Budget year (b)	b+1	b+2	b+3	b+4
Ministry I					
Administrative expenditure, core ministry					
Administrative expenditure, agency 1					
Administrative expenditure, agency 2					
Etc.					
Programme A					
Sub-programme A1					
Sub-programme A2					
Etc.					
Programme B					
Etc.					
Ministry II					
Administrative expenditure, core ministry					
Administrative expenditure, agency 1					
Administrative expenditure, agency 2					
Etc.					
Programme C					
Sub-programme C1					
Sub-programme C2					
Etc.					
Programme D					
Etc.					
Ministry III					
Etc.					

Feasibility of the reform

The development of a programme classification is an exercise that cannot be based on abstract reasoning about the responsibilities of ministries, but rather be guided by bottom-up reasoning based on the sectoral laws and policy structures that are currently in place. Therefore this exercise can only be done in close co-operation with the line ministries. Moreover, the Parliament should be involved since the reform directly impacts on its authority over the budget. In the countries that have introduced a programme classification, it is generally done under the common responsibility of the line minister and the Minister of Finance and the resulting classification is approved by Parliament.

If the above-mentioned conditions with respect to the budget documentation and rules of budgetary discipline are met, the reform is feasible in all OECD countries.

Reform 7.2. Regular updating of baseline estimates

Characteristics of the reform

Baseline estimates are the estimates of the costs of current policies in future years. They present the implications of current policies for the most detailed expenditure groups (line-item level) in the budget year and in the two, three or four years following the budget year. The role of baseline estimates is threefold:

- They provide the basis for maintaining budget discipline;
- They provide the basis for multi-annual expenditure planning;
- They provide indispensable information for the setting of expenditure ceilings.

To fulfil these roles properly and provide a reliable picture of the future budgetary consequences of current laws and/or policies at any given point in time, baseline estimates must be regularly updated. The updates must be carefully checked by the Ministry of Finance and periodically reported to Parliament.

Where did it occur?

OECD countries have different cycles for internal updating of baseline estimates; for instance, the Netherlands updates 6 times a year (a two-monthly cycle), Denmark updates three times a year (a four-monthly cycle) and Sweden updates four times a year (a three-monthly cycle).

Some countries that do not use an expenditure framework still have a strong procedure of baseline updating as a basis of budgetary discipline: Australia, New Zealand, Norway have strong budgetary discipline, low deficits and low public debt. In this light it can be argued that strong baseline procedures are even more important for budgetary discipline than strong expenditure frameworks.

Analysis

Current policy and current law baselines

Multi-annual estimates can be established either on the basis of current law or on the basis of current policy. Current law estimates forecast the future expenditures flowing from substantive (non-budgetary) laws that are in force at that time of calculation. Current policy estimates forecast the future expenditures flowing from government policies that are presently in place. The difference between these two types of estimates is that current law estimates do not extrapolate budgetary estimates of previous years if expenditures are not based on substantive laws (hence only on budget laws). Thus, expenditures for infrastructure investments that are not based on substantive laws will not be included in current law estimates. The other difference is that current law estimates do not include expenditures which follow from approved policies, if these policies are not enshrined in substantive laws or if the laws are not yet enacted.

Budget discipline

In view of budget discipline, there are three reasons for regular updating of multi-annual estimates:

1. Under existing laws or policies, demand for services may be larger or smaller than foreseen at the time of budget approval both in the budget year and future years.
2. Cost per service may be larger or smaller than foreseen at the time of budget both in the budget year and future years.
3. Some policy changes cannot be postponed to the next budget year and they affect the current budget as well as future budgets.

In the budget year the appropriation approved by Parliament is a strict constraint on expenditures that may force the responsible minister to change policy during budget execution, but for the out-years there are no constraints at the line item level (in the case of an expenditure framework only at the level of total expenditures, possibly subdivided by ministries). Moreover, even for the budget year, a large proportion of expenditures is entirely determined by entitlement legislation that takes precedence over appropriations. In these cases (changes in the out-years, or changes as a consequence of entitlement legislation in the budget year) baseline updating can bring the threat of overspending to light and trigger corrective measures.

Inflation represents a special case regarding changes in costs per service. OECD countries that have moved to a programmatic classification use mainly two mechanisms for the compensation of cost inflation (wage costs and procurement costs). The first mechanism entails that budgetary and multi-annual estimates are stated in fixed prices of the previous year and that there is a separate line item for nominal compensation on the basis of multi-annual inflation forecasts. Compensation takes place by reallocation from this line item during the execution year on the basis of observed inflation. The second mechanism entails that inflation forecasts are built into budgetary and multi-annual estimates. In this case, inflation setbacks and windfalls are not automatically compensated but may, under certain conditions (large deviations, specific line items such as salaries), be compensated from a contingency fund. Whatever the mechanism, budgetary and multi-annual estimates should be updated as soon as new observations and forecasts become available.

The need for baselines is independent of the budget classification. Most countries that have adopted a programmatic budget classification prepare baseline estimates. However, up to date baseline estimates are also important for budget discipline in more traditional classifications (organisational, economic).

Multi annual expenditures planning

Many, indeed almost all, significant policy decisions have their most important impact after the upcoming budget year. New policies require time to phase in. Legislation has to be changed, executive agencies have to be reformed or built up, etc. This is true for new initiatives that require new spending as well as for new initiatives that lead to savings. Sectoral planning should therefore take into account the budgetary consequences for the medium term from the very start.

All policy decisions, submitted to government should therefore have an annex that spell out the budgetary consequences in the budget year and the out-years. Moreover, policies are not only decided during budget preparation, but during the entire year. Therefore, ministers should always be required to show how this will affect their budgets in the medium term and if there is an expenditure framework how this fits in their medium term ceiling, possibly after compensation on other line items.

Indispensable information for setting expenditure ceilings

The baseline estimates are indispensable for setting expenditure ceilings in countries that work with an expenditure framework (see Reform 7.3). The setting of ceilings requires availability of five kinds of information (see introduction to this chapter), including baseline estimates.

Without baseline estimates, ceilings cannot be set in a rational way. Indeed ceilings have to be based on a trade-off between revenues and expenditures (the ceiling for total expenditures), and between expenditures for separate sectors (the sub-ceilings for separate ministries and/or broad policy sectors). When they set ceilings policy makers have to know whether their decision imply more or less taxation or whether they imply room for new spending initiatives or savings in particular ministerial envelopes.

Responsibility for updating

The line ministries are responsible for regular updating of baseline estimates. However, updates should be checked by the Ministry of Finance. This is a technical, not a political matter. The central question is what the policy will cost if no measures are taken. In principle agreement should be reached at the level of policy experts of the line ministry and the Ministry of Finance. However, in case of a difference of opinion the matter should be decided at the level of senior civil servants of both ministries.

In many OECD countries, the largest part of the central government budget is determined by expenditures based on large demand-driven entitlement laws in the sphere of education, health, social security and grants to local governments. This implies that the reliability of baselines for these programmes is critical. These estimates are sometimes produced by forecasting models owned by the line ministries. These models can also simulate the budgetary consequences of changes in the entitlement laws. Given the importance of these forecasts for the macroeconomic steering of the budget, it is important that in these cases independent experts also look at these estimates. In countries where independent public forecasting bureaus exist (the Netherlands, the Nordic countries), these bureaus have a role in the updating or supervision of these estimates.

Transparency

Baselines are in the first place a means to ensure budgetary discipline and to facilitate multi-annual expenditure planning and the setting of ceilings within the government. However, the parliament should be informed, particularly at times when appropriations or supplementary appropriations are submitted for authorisation. This implies that (supplementary) budgets should always contain information about the baselines at the line item level, preferably in the body of the budget law (not in an annex). This does not mean that parliament should authorise the baselines. In almost all OECD countries parliament only authorises the estimates for the budget year. However, it means that parliament is informed about the multi-annual implications of the decision for the budget year and can exercise its power of the purse in the light of this information. Moreover, in order to

understand the information about the baselines, this information should be explained in the budget documentation. In particular the budget documentation should contain a horizontal and vertical explanation of the baselines.

The horizontal explanation of the budgetary and multi-annual estimates

The horizontal explanation of the estimates has to provide a clear picture of the development of the estimates at the line-item level from the budget year until the last out-year. The explanation should look at developments in the demand for services and the costs of services under current policies. This explanation is called “horizontal” because it looks at the development of the estimates over time at a given moment in time.

The vertical explanation of the budgetary and multi-annual estimates

The budget documentation also has to explain how the line-item estimates have changed since the previous year. This explanation is called vertical because it looks at the change in the estimates at subsequent moments. In this respect, it is important to distinguish between policy changes and setbacks/windfalls under current policies. The setbacks and windfalls in the vertical explanation are the sum of all updates of the estimates during the previous year that do not arise from policy change, but rather from unexpected developments in the demand for services under current policies or in the costs of services. Policy measures have to be separated out, so that readers can understand the impact of separate measures that have been taken during the previous year.

Feasibility of the reform

Almost all OECD countries prepare base line estimates, but internal updating practices vary. The frequency of the updates varies from every three or four months to every year. Furthermore not all countries report baseline updates regularly to Parliament, including compensatory measures in case of overspending. The frequency of reporting to Parliament typically depends on the country’s financial reporting procedures, because the baseline updates are usually integrated with financial reports. Parliament should be informed properly, including horizontal and vertical explanation. Many OECD countries can further improve their updating and reporting procedures.

Reform 7.3. Medium term expenditure framework

Characteristics of the reform

This reform consists in introducing or strengthening an expenditure framework that is a normative constraint on the total expenditures of central or general government over the medium term. The framework can be flexible (changeable from year to year) or fixed (not changeable). Countries that use a flexible framework often try to maintain their framework as constant as possible from year to year, although changes are possible under certain conditions; hence the difference between flexible and fixed frameworks may not be very large in practice.

Medium term expenditure planning implies that the budget documentation contains forward ceilings for central or general government as a whole and sometimes for ministries or broad expenditure groups for a period of 2 to 4 years after the upcoming budget year. The ceilings are decided at the beginning of the budget process (top-down budgeting) on the basis of macro-economic and revenue forecasts, costs of current and new programmes, fiscal rules or long term objectives and fiscal consequences of revenue

options. In the budget process decisions are taken in order to make sure that the expenditure estimates for the upcoming budget year and for the following years at the line item level (baseline estimates) fit into the ceilings for those years. If there is room between the ceiling and the sum of the baseline estimates in any year, new spending initiatives can be allowed. If the sum of the baseline estimates exceeds the ceiling in any year cuts are required. Both baseline estimates and ceilings for the out-years are published in the budget documentation.

The reform also implies the establishment of strong rules of budgetary discipline that require immediate compensation by the line minister of any overspending on the ceilings of the budget year or the out-years during budget preparation and budget execution (until the next framework comes into force). For this purpose it is required that base line estimates are regularly updated (at least three times a year) and carefully checked by the Ministry of Finance.

Where did it occur?

Almost all OECD countries nowadays work with medium term expenditure frameworks (MTEFs), New Zealand being the notable exception. A large majority of the countries use flexible frameworks. A limited number of OECD countries use fixed expenditure frameworks in their budget process, notably: the Netherlands, Sweden, and the UK.

One of the differences between the fixed frameworks in use in the Netherlands, Sweden and the UK is the frequency of the framework's revision. The framework of the Netherlands is periodical in the sense that it is decided during the cabinet formation and covers the entire cabinet period. Ever since the introduction of the framework procedure in 1994, a new framework was decided at the beginning of each cabinet period for four years (but sometimes a cabinet fell before the four years were over, which led to a new framework of a new cabinet but again for four years). The framework of the UK has always been for three years since the introduction of the framework procedure in 1998. In Sweden the framework is on a rolling basis, every year one year is added at the end of the planning period.

However, the difference between the periodical frameworks in the UK and the Netherlands and the rolling framework in Sweden is not as large as it might seem. In the Netherlands the framework is in fact extended every year as well with one new out-year, but the ceilings in the out-years after the cabinet period cannot comprise new policies (either savings or new spending) to be implemented after the end of the cabinet period (in contrast to ceilings in the out-years during the cabinet period, which can comprise new policies to be implemented in out-years). This resembles the Swedish procedure, which excludes new policies to be implemented in all out-years (not only in the new cabinet period). Furthermore the Swedish procedure also allows for the revision of the entire framework at the start of a new cabinet period, if a new cabinet so decides. In the UK the framework is usually revised after two years, whereas the existing framework still contained a third year. The current framework established by the incumbent coalition government covers the period 2012-2014. In this light the procedures in the three countries are very similar as far as the frequency of revision is concerned.

Analysis

Fixed and flexible frameworks

The use of a flexible expenditure framework has important advantages compared to a budget process that does not start with ceilings or that focuses exclusively on the upcoming budget. Starting with a ceiling makes sure that there can be no creep in the total during budget preparation, as was usually the case in the era of “incremental budgeting”, when the Ministry of Finance and line ministries started with their respective bids and the outcome ended up somewhere in between. The multi-annual perspective makes sure that future consequences of new spending initiatives are taken into account and have to be reconciled with future ceilings (constraining “camel noses”). Similarly it makes sure that savings that are necessary in future years are decided now. This implies a more structural approach to savings. This is particularly important because important savings usually require various years to phase in since they require changes of laws and reorganisations.

Compared to a flexible framework, a fixed framework has two additional advantages:

1. It leads to a strict separation of expenditure and revenue planning. Revenue windfalls cannot lead to more room for expenditures and revenue setbacks do not trigger consolidation. Expenditure frameworks lead therefore to automatic stabilisation. They are not anti-cyclical in the sense that windfalls lead to savings and setbacks to expansion, but a-cyclical, or neutral in the sense that revenue windfalls and setbacks do not affect expenditures. Automatic stabilisation is usually seen as more effective than anti-cyclical activism, because of timing problems (the recession is over when the stimulus phases in, the boom is over when the consolidation phases in) and the disruptive effect of activism on programme planning and the budget process in general⁹.
2. The effect on budgetary discipline is substantially stronger: line ministers cannot hope to survive the current problems by *ad hoc* measures and accounting gimmicks and get more money in the next year. Even though reallocation between sub-ceilings is generally allowed during budget preparation, every line minister knows that reallocation in his/her favour is very difficult to bring about since it has necessarily to go at the cost of a colleague. This implies that every minister knows what he gets for the entire period of the framework. The effect of this arrangement is that line ministers start to behave as “their own minister of Finance”. It also implies a considerable change in the task of the ministry of Finance. It does not negotiate anymore about allocation, but it monitors and enforces the rules of the game. These rules are the rules of budgetary discipline which tend to be quite extensive and elaborate under fixed frameworks. In addition the Ministry of Finance has to carefully supervise the regular updating and reliability of the base line estimates, because these estimates are the fundament of the budget process under a fixed expenditure framework. They trigger any savings decision to comply with the framework and they must permit any new spending initiative that respects the framework.

Expenditure frameworks and fiscal rules

An expenditure framework has to be anchored in a fiscal rule. This can be the deficit and debt rules of the European Union (a 3% headline deficit limit and a 60% headline debt limit) or the (structural) Medium-Term Objectives of the Stability and Growth Pact if a country exceeds the headline limits, but it is safer to steer on national fiscal rules that

are stricter than the EU rules¹⁰. Many OECD countries anchor their expenditure framework in a structural balance rule (balance over the economic cycle). The estimation of the structural balance is a difficult exercise. It gives rise to deviating estimations and leads to a certain degree of arbitrariness. This problem occurs in all countries that anchor their framework in a structural balance rule (also if the framework is flexible), but it is mitigated to some extent if the framework is fixed, because in the latter case it only comes up when the framework is revised (or extended, but then only for the extension year at the end of the planning period).

Many OECD countries nowadays try to anchor their fiscal policy in long-term sustainability analysis. This requires that public debt does not exceed a certain percentage of GDP or gradually converges to a sustainable level if it is currently too high (for instance the 60% of the Growth and Stability Pact). In addition it requires that future demographic developments can be absorbed without pushing the public debt over its agreed limit. In case of an ageing population this usually means that public debt should be reduced well below the agreed limit in the coming decades in order to allow it to grow in the longer term until a demographic balance is reached. This in turn implies a substantial surplus target for the balance in future decades.

A particular feature of a fixed expenditure framework is that revenues and the headline deficit fluctuate according to the economic cycle without affecting expenditures. However, if the framework is anchored in a deficit rule, the revenue side of the budget has to be constrained as well. For this purpose it is necessary to fix tax policy at the same time as the expenditure framework for the same period. Subsequently, budgetary discipline at the revenue side has to be guaranteed equally by a compensation requirement. This can be called a “pay as you go” requirement using the terminology of the Budget Enforcement Act that was in force in the USA in the nineties of the previous century (abandoned in 2002). It requires that every enacted change in tax policy is fully compensated in other enacted changes at the tax side of the budget. For instance tax relief in the income tax has to be compensated by tax enhancement in indirect taxes or vice versa. In order not to affect the deficit, both tax relief and tax increases should be compensated. Note that the compensation requirement applies to the estimated change in the tax yield flowing from the enacted changes in the legislation. The compensation requirement does not apply to autonomous cyclical effects under current legislation (this is the essence of automatic stabilisation).

Countries that have constraints on the revenue side of the budget in place, usually have determined a band of fluctuation for the actual tax yield. If the boundaries of this band are exceeded, the underlying change in GDP is considered as structural. If tax revenue exceeds the upper boundary of the band a part of the growth is considered as structural and therefore available for tax relief (“return to the citizens”).¹¹ If, on the other hand, tax revenue falls short of the lower boundary of the band, this may require revision of the expenditure framework to restore the structural balance requirement in the medium term¹². Under a fixed framework structural windfalls give rise to tax relief whereas shortfalls may give rise to downward adjustment of the expenditure ceilings. This reflects the notion that deficit problems should in the first place be solved at the expenditure side whereas the benefits of buoyant growth should at least partly be given back to the citizens.

Coverage of the framework

The choice of coverage has to address two main questions:

1. Should mandatory expenditure be included?
2. Should interest on public debt be included?

In the UK the ceilings (“Departmental Expenditure Limits”, DEL) apply to discretionary spending and exclude mandatory expenditures, so called Annually Managed Expenditures (AME). This applies mostly to social security. However, education and health expenditures, that have in some countries the character of mandatory expenditures (because they are in those countries completely determined by law) are considered in the UK as discretionary and thus are included under the ceilings. DEL included around 60% of total spending and AME around 40%. DEL ceilings are set separately for current and capital budgets in order to protect investment (ministers cannot compensate setbacks on current spending by cutting investments). An argument for excluding AME expenditure is that some of it is cycle related, in particular unemployment benefits, so that exclusion may contribute to automatic stabilisation. In Sweden and the Netherlands, the ceilings include both discretionary and mandatory spending. The logic behind this is that the very reason for working with multi-annual frameworks is that setbacks on mandatory spending can often be anticipated years in advance so that timely measures can be taken to change the laws. Furthermore in Sweden and the Netherlands a larger share of expenditure is completely determined by law and thus mandatory (for instance education spending and all grants to local government in the Netherlands). Excluding mandatory spending would thus deprive the frameworks of their effectiveness. Finally, most mandatory spending is not cycle related, so that the automatic stabilisation argument is not very strong.

Interest payments on public debt are excluded from the ceilings in the UK and Sweden (in the UK because they are AME). The main argument is that these expenditures are accounted for on the budget of the Ministry of Finance and that ministry has little room for manoeuvre to compensate for large setbacks. In the Netherlands interest payments were under the ceiling from 1994 to 2008, then taken out from 2008 to 2011, then included, and since 2012 again taken out. The temporary exclusion from 2008 to 2011 was presented as a “stimulus measure” to the European Commission. There was not much else behind this measure. The current inclusion is mostly due to the pragmatic reason that public debt has risen substantially in current years, which makes it increasingly difficult for the Minister of Finance to find compensation for overspending in a relatively small budget.

Feasibility

When introducing or strengthening a MTEF, the authorities have to decide on the main features of the framework procedures and in particular on whether the framework will be fixed or flexible, on the anchoring of the framework in a fiscal rule, on the constraints at the revenue side of the budget and on the coverage of the framework.

Fixed framework has additional advantages compared to flexible frameworks but require relatively low volatility of GDP development and an extensive set of precise rules of budgetary discipline that should be subjected to explicit government approval.

Governments may consider anchoring the expenditure framework in a balance rule that is stricter than the EU deficit rule and that is based on long-term sustainability

requirements. Governments are also advised to consider introducing a “pay-as-you-go” requirement on the revenue side of the budget that includes tax expenditures.

When introducing this reform, it is important to consider that the advantages flowing from the multi-annual perspective are only realised if the reconciliation requirement between base line estimates and ceilings in out-years is taken seriously, which requires reliable estimates, which are regularly updated and published in the budget or the budget documentation. It also requires that estimates for the out-years are carefully checked by the Ministry of Finance. In a budget process that is based on expenditure frameworks, line ministries have an interest in keeping base line estimates for the out-years low in order not to trigger savings decisions. If the problem arises a year later, it is often too late for structural measures, so that the line minister may hope to receive more resources for funding of ongoing programmes. In a flexible framework this hope is the more realistic because the framework can be changed from year to year. Paradoxically, the Ministry of Finance sees itself therefore often in a position to plead for higher base line estimates in out-years and this incentive is stronger to the extent that the framework is more flexible (in the sense that the budgetary culture is more permissive to annual change of the framework). It can also help to have a check on the base line estimates of major programmes with demographic components (education, social security, health, social services) by an independent forecasting institution.

Reform 7.4. Focusing the budget documentation on financial information

Characteristics of the reform

The reform consists in providing more concise information in the budget documentation focusing on the expenditures for policy instruments and administrative expenditures, while moving information on results to ministerial policy documents and evaluation reports.

The reform can lead to better readable budget documentation of smaller size that responds better to the needs of parliamentarians and the public.

The reform supposes that the budget is classified according to a programmatic classification (see Reform 7.1). The budget documentation provides information on the costs of separate policy instruments, in particular if the line item of the budget consists of various policy instruments, and on the administrative expenditures of the ministry, split out in expenditures of the core ministry and the various agencies, and, as far as the core ministry and the agencies are concerned, the main components of the administrative expenditures, such as salaries of civil servants and contract employees, procurement of goods and services and ICT.

Where did it occur?

Whereas in many countries reforms have taken place in the last few years that aim to improve the readability and relevance of the budget documentation to parliamentarians and the public, the Netherlands has implemented the most far reaching reform in this respect. The memorandum “Accountable Budgeting” submitted to Parliament in 2011 contained proposals to revise the budget documentation in order to implement this reform in two stages, the first in the budget 2012 and the second in the budget 2013. Currently the reform has mostly been carried out, although some aspects still have to be fine-tuned (Ministry of Finance of the Netherlands, 2011).

Analysis

Shortcomings in the informational content of the budget and the budget documentation

The New Public Management reforms of the 1990s have in many countries led to unexpected and unintended consequences, including a large extension of the budget documentation. In particular the budget documentation was often packed with performance information (information on outputs and outcomes) that obscured how public resources were actually used, that did little to clarify the responsibilities of the minister, and that, according to critics, sometimes had the character of “government propaganda” (see Chapter 1 for a general survey of the unexpected consequences of New Public Management”).

In the Netherlands this led to complaints by Parliament. In particular parliamentarians noted that the reduction of the number of line items in the budget from 800 to 160 as a consequence of the introduction of a programme classification, had obscured insight on how public resources are actually used. Programme articles sometimes included a number of policy instruments, whereas the costs of each did not appear in the budget or the budget documentation. In addition most ministries had divided administrative expenditures over programme line items. Other ministries had a central line item for administrative expenditures but did not split it out over types of operational means, such as salaries and ICT expenditures. Moreover, output and outcome information did not make clear the responsibility of the minister and the extent to which the minister had control over outputs and outcomes or are achieved mainly by non-financial instruments such as legislation (outputs are often determined by entitlement legislation and outcomes are determined by many factors over which the minister has little control, for instance reduction of school drop-out or protection of human rights in foreign countries. In addition parliamentarians noted that it was often not clear what the policy consequences were of performance information and policy evaluations. In summary the virtual elimination of input information from the budget and the budget documentation, combined with the unfulfilled promise of performance accountability using output and outcome information, left parliament with a sense of loss of control. This was increasingly perceived as an accountability gap.

Complaints of a similar nature have been heard in several other countries that have been visited for the purpose of this study. The current reform seeks to address these problems by proposing a number of remedies concerning the budget documentation. They focus on 1) the content of the financial information to be included, 2) the content of the policy information to be included.

Financial information to be included in the budget documentation

The budget is a financial document. It fulfils several functions: allocational, macro-economic, managerial, but its first function is that of authorisation: it serves as a vehicle for Government and Parliament to decide on how public resources are spent. This has consequences for the budget classification and the budget documentation. The New Public Management School assumed that Government and Parliament were only interested in the realisation of policy aims, but this is not factually the case. Parliamentarians have interest in how resources are actually spent, and for good reasons that are explained in Chapter 1. This has two consequences for the budget classification and for the budget documentation. First, classification and documentation must specify

the costs of separate policy instruments. Second, classification and documentation must specify administrative expenditures.

A programme classification is generally characterised by a limited number of line items (see Reform 7.1). Expenditures are divided on the basis of programmes with a common policy aim, sometimes split out in sub-programmes. However, it often occurs that under the same programmes or sub-programmes expenditures are authorised that cover the costs of several policy instruments. Policy instruments are conceived in this context as separate subsidies, social benefits, programme investments¹³, transfers to local government and international organisations, etc. Some countries that have moved to a programme classification have split out expenditures for separate policy instruments in the budget documentation as “activities”, for instance France. However, others have not. There is a trade-off between the number of line items and the degree of specification of the policy instruments. It can make sense to limit the detail in the classification, provided that the information on the separate policy instruments is still provided in the budget classification. The expenditures for the separate instruments are then not subject to parliamentary authorisation, but the Parliament can still exert its power of the purse by approving or amending the line items in light of the information provided in the budget documentation. This practice contributes to the conciseness and readability of the budget and reduces the need for supplementary budgets if government decides to reallocate resources between policy instruments after the budget has been approved. This requires of course regular reporting on budget execution (that is important for other reasons as well), so that parliament can intervene during the course of the execution year if resources are used for other purposes than it is willing to approve.

Parliamentarians also have an interest in administrative expenditures. In principle this information could be provided in the budget documentation as well, rather than through the budget classification, but in practice this solution leads to many difficulties. It requires that for the purpose of the budget classification, administrative expenditures are split among programmes. However, administrative expenditures cannot easily be split out in this way. Typically the core ministry divides its administrative resources over the programmes in a flexible way. Many officials, especially those that fulfil positions at the higher levels of the hierarchy work on several programmes and policy instruments simultaneously and the attention that they give to separate programmes and policy instruments differs from day to day and from period to period. This makes the splitting of administrative expenditures among programmes and policy instruments an arbitrary exercise. Moreover, many agencies carry out several programmes and policy instruments. One can think of agencies that execute subsidy programmes, or social benefits or grants to local governments. Splitting out the expenditures for separate programmes and policy instruments is then a similarly arbitrary endeavour. Experience shows that it leads to endless internal discussions and high administrative costs. Furthermore the significance of the line item estimates is obscured if they can contain administrative expenditures. Finally, including administrative expenditure in programmes can lead to leakage of programme expenditure into salaries and accommodation, which Parliamentarians want to prevent (see Reform 7.1).

In this light it is preferable to keep administrative expenditures apart from programme expenditures in the classification and to subject them to separate parliamentary authorisation (see also Reform 7.1).

Nevertheless, even if this is done, parliamentary interest in administrative expenditures usually goes further than the totals for the core ministry and the agencies.

Members of parliament are typically interested in civil service salaries, costs of contract employees, procurement of goods and services, costs of ICT, etc. Here the reasoning applies that this information can be given in the budget documentation without impairing the power of the purse, in a similar way as the information about separate policy instruments.

According to the Dutch reform the administrative expenditures of the core ministries will be authorised in a central article for operational expenditures (“*apparaatsuitgaven*”, “apparatus expenditures”). Insight in the various types of operational expenditures of core ministries, in particular salaries, costs of contract employees, costs of ICT and costs of other procurement of other goods and services, will be provided in the budget documentation

The budget will also provide an overview of the total operational costs of arm’s length agencies (arm’s length agencies have an accrual administration: hence costs instead of expenditures). The split in kinds of operational costs of arm’s length agencies will be provided in separate agency articles of the budget.

The budget documentation will also provide an overview of the total operational costs of administrative independent agencies¹⁴, but the overview will not present the split in kinds of operational costs of these agencies. This does not seem entirely consistent with the logic of the reform. The minister is accountable for the operational management of administrative independent agencies. These agencies have a special statute that prohibits government interference in their executive policy and decisions in individual cases, but the minister remains accountable for their operational management. It seems logical to split the operational costs of administrative independent agencies in a similar way as the operational costs of arm’s length agencies in the budget documentation. Administrative independent agencies, even if they have legal personality, typically lack the internal procedures of efficiency scrutiny that are characteristic for public non-profit institutions tasked with service delivery (universities, cultural institutions such as museums, etc.)¹⁵.

In spite of the fact that the total operational costs of the agencies are presented in the budget or the budget documentation, the public contributions to some arm’s length agencies (the ones that are not shared service centres) and all independent agencies are authorised as programme expenditures. This seems unnecessarily complicated. It would be simpler to authorise all public contributions to the operational costs¹⁶ of administrative agencies as administrative expenditure (next to the operational expenditure for the core ministry, see Reform 7.1 for how the budget classification would look like in that case).

A special problem concerns the operational expenditures of service delivery units such as the military and the police. As far as these units are concerned, the Dutch reform includes a rather complicated set of rules which imply that under certain conditions the expenditures on salaries and goods and services of these units can be authorised as programme expenditures and not included in the administrative expenditure article of the core ministry, nor in the survey of administrative expenditures in the budget documentation. The arrangement seems rather complicated and not entirely satisfactory since it does not apply to all service delivery units in the core ministry or the agencies. It would be simpler and more in line with the rationale of the split between programme expenditure and administrative expenditure to exclude all expenditure on salaries and goods and services of service delivery units inside the ministries and agencies from the definition of administrative expenditure, and thus from the survey of administrative expenditure in the budget documentation (see Table 2.1 in Chapter 2).

Furthermore, it deserves attention that in many counties educational establishments (which in the Netherlands are public non-profit institutions or municipal agencies) and care providers such as hospitals (which in the Netherlands do not belong to central or general government sector at all) belong also in this category of service delivery units without legal personality for which it is reasonable to specify their expenditures on salaries and goods and services as programme expenditures.

Policy information to be included in the budget documentation

If the focus of the budget documentation is put (again) on financial information, the question arises what policy information should remain. In this respect the Dutch example is illustrative.

In the Dutch reform it is emphasised that Parliament and the public are in the first place interested in what the responsible minister (and thus the government) wants to achieve and what she/he has done for that purpose. The budget documentation is not the place for extensive expositions of the aims and instruments of sectoral policies in general. This information should be provided in periodic sectoral documents (sectoral plans for the medium or long term, in some sectors with annual updates) and should not be repeated from year to year in the budget documentation. Rather the line ministers should be invited to provide a short summary of what they intend to change during the upcoming budget year in her/his policy aims and policy instruments that will have budgetary consequences reflected in the budget and the baselines for future years.

As to policy information in the budget documentation, the Dutch reform emphasises the importance of policy evaluations. The line ministers are responsible for policy evaluations but before the reform the budget documentation gave at best a fragmented overview of these evaluations divided per line item. The reform includes the provision that the budget documentation should list all evaluations, that have taken place in the previous year (including publication references) and that are planned for the upcoming years (the budget memoranda contain a multi-year schedule for policy evaluations) per ministry, as well as the consequences drawn from the past evaluations for policy adjustments in the coming year, including the consequences for the upcoming budget and the baselines for future years.

As to performance indicators, the Dutch reform is based on the idea that indicators of processes, outputs and outcomes can be provided in the budget documentation if these results are measurable and the indicators make sense and can be influenced by the Minister. If this is not the case they should be omitted. This has led to a lively discussion between the Ministry of Finance and the line ministries on which indicators are worth to include in the budget documentation. Given that evaluation is seen as a responsibility of the line ministries and that evaluations must be published by the line ministries, it would have been more consistent to stipulate that performance information should be provided in sectoral policy documents and not at all in the budget documentation. Nonetheless, in the Netherlands, the number of indicators was roughly halved in comparison to the old budget memoranda.

Finally the Dutch reform includes a (strict-) limit on the number of pages of the budget documentation. This provision is important because it supports various other components of the reform, in particular the limitation of policy information to what the minister intends to change in the upcoming budget year and the provision that performance information should be limited to results that are measurable and indicators that make sense.

Feasibility of the reform

The reform is feasible in all OECD countries that have moved to a programme classification. The split of programme line items in separate policy instruments in the budget documentation is in particular important for countries that have reduced the number of programme articles to the extent that the line items authorises expenditures for more than a single policy instrument. The introduction of a central line item for administrative expenditures of each ministry is in particular important for countries that have tried to split administrative expenditures according to programmes.

In addition, the expectations of results accountability through performance information in budgets were not met. Putting more emphasis on the financial consequences of changes in policy aims and instruments can help produce more informative and transparent budgets.

Reform 7.5. Automatic cuts of productivity dividends

Characteristics of the reform

This reform consists of automatic, annual cuts of productivity dividends in appropriations, available for distribution to priority areas or for savings. The reform is based on the assumption that production of goods and services in the public sector leads to annual efficiency gains similarly as in the private sector. These annual dividends are a result of productivity growth and can be estimated. A corresponding reduction in appropriations (called here “cuts of productivity dividends”) can thus be applied. If the efficiency gains are not taken into consideration, they can lead to backdoor increases in service levels. When taken into account, these productivity dividends can be subjected to annual mandatory cuts.

This reform has two essential characteristics: first, the cuts of productivity dividends are “automatic” in the sense that they are part of the regular budget process and do not require special decisions from year to year as to their application; and second, the cuts are at least applied to the operational expenditures¹⁷ of central government.

Where did it occur?

Such cuts are applied in a number of countries participating in the Value for Money Study: Australia, Denmark, New Zealand, and Sweden. In Finland there is no practice of automatic cuts as such, but the programmes for Central Government Productivity (from 2007) and for Effectiveness and Productivity (from 2011), that were introduced as *ad hoc* saving operations in the country, have some characteristics that are similar to cuts of productivity dividends.

Analysis

Key features of the reform

The main argument for this reform is that the traditional assumption that in the public sector productivity growth is zero is not realistic. This conventional assumption has been reconsidered in the past years and some OECD countries have started exploring options for measuring the value for public outputs, thus accounting for productivity development, and applying automatic annual cuts to avoid backdoor increase in service levels.

The key features of the arrangements in these countries are summarised in Table 7.2 below.

Table 7.2. Key features of the arrangements of the reform

	Terminology	History	Baseline and size	Coverage
Australia	Efficiency Dividend	<ul style="list-style-type: none"> Introduced in the 1987-1988 Budget. A precursor to the efficiency dividend was introduced in the 1986-1987 Budget which aimed to achieve a general efficiency saving of 0.5% in salaries and 1% in administrative and operational expenditures. 	<ul style="list-style-type: none"> 1.25% per annum from 1987 1.0% from 1994 1.25% from 2005 (up to 2% in 2008-2009) 1.5% from 2011 1.25% from 2013 1% from 2015 	<ul style="list-style-type: none"> A uniform percentage decided by the Government is applied to the operational expenditures of all ministries and agencies in the general government sector unless they are exempted by the Government.
Denmark	"Reprioritisation contribution"	<ul style="list-style-type: none"> A uniform, automatic annual budget cut of 2% was introduced in the mid-1980s. From 1987 the cut rate varied from agency to agency on the basis of empirical productivity studies, but on average was about 2.5%. The empirical estimates were not considered very reliable and were open to criticism. In 1993 it was replaced by a uniform 2% cut. 	<ul style="list-style-type: none"> 2% cut is applied to the operational expenditure of central government in the last out-year of the four year budget forecast (baseline) that is part of each year's budget. The base varies as different parts of central government are exempted depending on government priorities and special political agreements. 	<ul style="list-style-type: none"> Institutions and programmes subject to special political agreements are exempted from the cut. Exemptions on this ground account for approximately 1/3 of central government operating expenditure (the remaining 2/3 is subject to the cut), but the percentage varies from year to year.
Sweden	"Deduction in Productivity Growth (DPG)"	<ul style="list-style-type: none"> From 1994 agencies were no longer automatically reimbursed for increased wage costs. The same wage index started to be applied later in the agencies to all agencies (if an agency's service output is kept unchanged, it is assumed to be able to produce this output with decreased wage resources because of the corresponding increase in the productivity of labour). 	<ul style="list-style-type: none"> The DPG is calculated as the average productivity growth in the private sector (1% - 2%). Productivity is calculated by dividing the real contribution of the sector to GDP by the number of labour hours worked in the sector. 	<ul style="list-style-type: none"> The DPG applies to ca. 16% of the total budget (the percentage represents the base amount subject to DPG).

Table 7.2. Key features of the arrangements of the reform (*continued*)

	Terminology	History	Baseline and size	Coverage
New Zealand	"Fixed Nominal Baselines" and from 2012, an additional "efficiency savings" is applied.	<ul style="list-style-type: none"> New Zealand has had Fixed Nominal Baselines since the early 1990s on all baselines excluding some specific items. In addition, the Cabinet decided in April 2011 to implement efficiency savings on core governmental administration. 	<ul style="list-style-type: none"> Nominal current operational expenditures are used as baseline in the annual budget cycle meaning that inflation has to be absorbed. Given that the inflation rate has been around 2.5% for the last few years, ministries had to achieve a similar productivity gain in order to maintain their existing level of output. The efficiency savings (3% for small agencies and 6% for larger agencies) are applied to agency component of the current operational expenditures (not to the core ministries). 	<ul style="list-style-type: none"> Fixed Nominal Baselines for operational expenditures are applied on the entire central government budget, without exception.
Finland	"Central Government Productivity Programme" (from 2007) "Programme for Effectiveness and Productivity" (from 2011)	<ul style="list-style-type: none"> In the context of an ad hoc saving operation, productivity targets until the year 2015 (cuts in operational expenditure) have been decided. 	<ul style="list-style-type: none"> The cuts are based on increasing labour productivity and are implemented via four-year Spending Limit Decisions and annual budgets. The annual percentage cut is differentiated between policy areas. The average requirement is a 1% cut for the government as a whole. 	<ul style="list-style-type: none"> All ministries were asked for productivity plans to increase productivity and these plans were then used to decide the size of the cuts. Targets for staff reductions were converted into targets for cuts of current operational expenditures by using roughly the average cost of person work-year within the central government.

Measuring productivity in the public sector

Measuring productivity is the key challenge in implementing this reform. Productivity is generally defined as a measure of the amount of output (services in kind and administrative services) generated per unit of input (labour and capital). Strictly speaking, this is the definition of average factor productivity, which stands in contrast to the definition of marginal factor productivity (the marginal addition to output as a consequence of a marginal addition to an input).

Operational (or technical) efficiency is a relative concept: it measures the relative productivity of a production process. It can be defined as the amount of input required to produce a unit of output compared to the amount of input required in the optimal production process.

Productivity growth can be achieved by a better combination of inputs (the allocative efficiency of production), better quality of inputs, and better operational efficiency (changes in the production process).

The measurement of the public sector output, is complicated by, first, the lack of market prices (the majority of public services are not sold in competitive markets), and second, the difficulty of accounting for changes in quality of services. Despite its importance, comprehensive measures of the public sector's productivity have not been developed even in the most advanced countries. In the past, public sector output was typically measured by inputs and activities (such as how many customers received services or how many students were taught). The outputs produced have not received sufficient attention. Moreover, in the national accounts it has been commonly assumed (although not prescribed) that in the government sector the value of inputs equals the value of outputs. This assumption has not been conducive to developing output measures.

However, this output = input convention has increasingly come under scrutiny in recent years. Many policy makers and academics consider this as a major shortcoming and some OECD countries have started exploring other options for measuring the value for public outputs, thus accounting for productivity development. Governments around the world have begun to carry out the research and policy analysis aiming to identify the multiple factors that drive productivity improvements in the public sector (such as labour skills, new technologies, improved managerial capabilities and service innovations), to measure the impact of those factors, and to identify ways to manage those factors to improve productivity.

In light of this measurement challenge, it would be difficult in this stage to state a conclusion about the best model for measuring productivity in the public sector. However country experiences provide arguments for the following valuable principles that can be considered in designing and implementing the reform:

1. Given widely different approaches to the measurement of productivity in the government sector, it seems prudent to avoid an overly direct connection between the outcomes of productivity research and the cut rates. A direct connection may lead to a permanent policy debate about the appropriate cut percentages in the various areas of public service provision and a politicisation of productivity research. There is consensus that there is productivity growth in the government sector and there are approximate insights in the order of average growth in the government sector as a whole. This is enough to establish an effective

arrangement of productivity dividend cuts, based on an undifferentiated annual cut percentage.

2. The overview of country examples shows that the cut rate varies from 1 to 2.5%. There are basically two approaches to the choice of the cut rate. The first is a political decision informed by national and international productivity research. The second approach is the Swedish one, which basically calculates government sector productivity growth as a ten year moving average of productivity growth in the private service sector. The cut percentage may change from year to year but the changes are very small in view of the use of a ten-year moving average. This approach may have the advantage that it is less vulnerable to short term political considerations and that it ensures equal treatment of the private and public service sectors.

Feasibility of the reform

The experience of Australia, Denmark, New Zealand, Sweden and in part of Finland shows that estimating productivity gains and redistributing them annually to priority areas is a feasible and operational practice. The main advantage mentioned by the countries that use them is that automatic cuts change the baseline of current policy that serves as the point of departure for the annual budget process. This is seen by finance ministries as a strategic advantage in budget negotiations.

The critical element in designing and implementing the reform is to establish a proper cut rate in the absence of reliable estimates of productivity growth at the sectoral level. There are two key approaches in defining the cut rate: first, differentiating the percentage on the basis of empirical productivity studies; and second, using a government-wide percentage based on a reasonable average.

At present countries do not use the first approach, because it does not provide for reliable estimates and is thus open to all kinds of criticism. The second approach is partly political and therefore the acceptance of the reform by ministries and by the public is challenging. Even in Sweden, where the model is the least politicised (the cut rate is linked to productivity development in the private sector and not established by government decision), it has been debated and criticised before being agreed upon by political parties and civil society. However, automatic cuts of productivity dividends do not mean that the budget of all line ministries is substantially reduced from year to year. First, the cuts only apply to current operational expenditures which are generally a small part of ministerial budgets. Second, most ministries annually have new spending initiatives which may be larger than the automatic cuts. These two factors can play a role in moderating resistance against the introduction of the reform.

Reform 7.6. Strong spending review procedure, anchored in law

Characteristics of the reform

Spending Review (SR) is a tool of financial management aiming at evaluation of current spending programmes, in order to identify and recommend savings options and to make room for new initiatives, hence supporting both fiscal discipline and enhanced Value for Money across government. It is an evidence based assessment of spending efficiency, and more broadly of the efficiency and effectiveness of public policies.

The introduction of SRs can provide, on the one hand, savings (a SR is aimed at the development of concrete spending options varying usually from 5% to 20% of spending) and, on the other hand, a quality improvement in public policy (a SR evaluates the efficiency and effectiveness of current programmes and puts forward options for programme improvements next to savings options).

In contrast to policy evaluations by line ministries (see Reform 2.5), a SR has a different aim and follows different procedural rules. These are the three main differences:

1. SRs not only look at the effectiveness and efficiency of programmes under current funding levels but also at the consequences for policy outputs and outcomes of alternative funding levels;
2. the Ministry of Finance holds final responsibility for the spending review procedure; and
3. the follow up of spending reviews is decided in the budget process, so there is a direct link between SRs and budgeting (OECD, 2010).

Where did it occur?

Conducting SRs is a widespread practice in the countries participating in the Value for Money Study. Australia, Canada, Denmark, the Netherlands, and the UK have integrated SRs in the budget cycle either on annual or multi-annual basis. The table below summarises the key features of these national practices. Finland, Ireland, Spain and Sweden have also reported to conduct SRs, however their experiences are either recent and relates to the post-crisis consolidation measures or are not established as a permanent component of the budget process.

Analysis

Key features of the reform

The key features of the arrangements in these countries are summarised in Table 7.3 below.

Table 7.3. Key features of national practices

Country	History	Review topics and coverage	Organisational set up and key actors	Number of SRs	Linkage with the budget
Australia	<ul style="list-style-type: none"> Strategic reviews were introduced in 2007, replacing lapsing programme reviews. A special Expenditure Review Taskforce (ERT) was established in the Department of Finance and Deregulation (DFD). 	<ul style="list-style-type: none"> Topics are identified by the Minister of Finance who then requests Cabinet to agree on the proposed reviews. SR is not focused solely on operational efficiency, but has a whole-of-government focus, examining the alignment of programmes with government priorities, the effectiveness and the efficiency of programmes and potential budget savings. 	<ul style="list-style-type: none"> SRs are managed by the DFD (and Treasury in the case of tax expenditures) in close consultation with the responsible ministry. Each review is conducted over 4 to 6 months by a team of 4 members led by a senior Finance officer or by an independent chairman who is either a former civil servant or an eminent person. The team is supported by a consultative group of representatives from relevant ministries and agencies, including the Department of the Treasury and the Department of the Prime Minister and Cabinet, which provides expert advice to the team. Line ministries are invited to participate in the review via interviews or as part of a reference group, but they do not have any direct influence over the report or its recommendations. Reports are presented to the Finance Minister who brings it to Cabinet who takes the final decisions on implementation of review recommendations. There is a trend for these reports to be published. 	<ul style="list-style-type: none"> 12 SRs have been conducted since 2007. 	<ul style="list-style-type: none"> As the topics are selected at the start of the budget process, SRs assist the Cabinet to decide priorities in budget formulation. SRs are usually conducted during the budget preparation process.

Table 7.3. Key features of national practices (*continued*)

Country	History	Review topics and coverage	Organisational set up and key actors	Number of SRs	Linkage with the budget
Canada	<ul style="list-style-type: none"> SRs have been introduced in 2007. 	<ul style="list-style-type: none"> SRs are systematic and comprehensive assessments of all programme spending every 4 years, assessing how and whether the programmes are aligned with priorities, and whether they provide value for money. SRs three key aims are: <ul style="list-style-type: none"> to ensure the efficient and effective delivery of departmental programmes, to ensure that departmental spending programmes are aligned with the federal government core responsibilities, and to ensure that departmental spending is aligned with the government's key priorities. All reviews must identify options for programme redesign, and at least 5% of total spending must be "freed-up" for reallocation from the "lowest priority, lowest performing" policies. 	<ul style="list-style-type: none"> Treasury Board (TB) leads the SR process and the Treasury Board Secretariat (TBS) provides advice and guidance on its conduct. The responsible Ministry conducts the review in accordance with the Terms of Reference. Ministries are required to establish a Steering Committee, and establish under the committee their own "review teams" according to their assessment of how best to meet the requirements of the reviews. Ministries are required to engage an external expert to provide advice on their Strategic Reviews. The Minister presents the findings and results of the reviews to TB. TB (supported by TBS) reviews all the Strategic Review recommendations presented by Ministers and makes recommendations on the reallocation and reinvestment proposals as input into the Budget planning process. The Minister of Finance reports annually on results of the reviews in the Budget. The details of the reviews are Cabinet Confidences and are not published. 	<ul style="list-style-type: none"> In 2007 17 SRs took place, covering about 15% of total programme spending. In 2008, 21 SRs took place covering about 27% of total programme spending. In 2009 20 SRs took place covering around 23% of total programme spending. In 2010, 12 SRs took place covering around 30% of total programme spending. 	<ul style="list-style-type: none"> The results of SRs are considered by Cabinet as part of Budget planning, feed into the annual budget process and are announced in the annual budget.

Table 7.3. Key features of national practices (*continued*)

Country	History	Review topics and coverage	Organisational set up and key actors	Number of SRs	Linkage with the budget
Denmark	<ul style="list-style-type: none"> The SR practice was developed during the 80s' and 90's. 	<ul style="list-style-type: none"> Budget analysts identify subjects for SRs in an early stage of the budget preparation in view of upward pressure on spending ceilings and efficiency/effectiveness deficiencies. After internal decision making in the MoF and dialogue with the concerned line ministries, the MoF proposes a list of SRs to the Economic Committee of the Cabinet to decide. The reviews are conducted over a relatively short period of time (2-4 months) 	<ul style="list-style-type: none"> There is no standard framework and for each review the responsible unit and person in the MoF has a high degree of discretion on how to conduct it. In practice similar procedures are applied from year to year to organise and conduct SRs. For larger SRs external experts (consultants) are involved in the analysis and a steering committee with participation of the affected line ministry is set up. The line ministry contributes factual information and is involved in drawing conclusions from the review. The role of the MoF is to challenge established views and procedures. For smaller reviews, the organisation and procedures are less formalised, and the review is conducted in bilateral contact with the relevant line ministry. The Government's Steering Committee receives the recommendations and decides on proper reaction. SR reports are sometimes published (or made available on the Internet) after the Government has decided upon recommendations. 	<ul style="list-style-type: none"> Over the last years, the number of SRs has been in the range 10-15 annually (except for one year with 34 reviews). 	<ul style="list-style-type: none"> Expenditure adjustments are incorporated in next year's budget.

Table 7.3. Key features of national practices (continued)

Country	History	Review topics and coverage	Organisational set up and key actors	Number of SRs	Linkage with the budget
The Netherlands	<ul style="list-style-type: none"> • SRs are conducted annually as from 1981. Recently the procedure moved partly to a more periodic and comprehensive schedule (a multi-year review cycle). 	<ul style="list-style-type: none"> • The reviews must be primarily forward-looking and include reform options based on an evaluation of the current policy. • The reform options must lead to savings (in many years with a mandatory option leading to a spending reduction of 20%). • The procedure was invigorated during the fiscal crisis when a comprehensive review of all major spending programmes in the public sector took place (some 20 reviews). The current trend is to move to a multi-year review cycle in which all major spending programmes are reviewed in the year before elections (although <i>ad hoc</i> reviews during the cabinet period are not excluded). 	<ul style="list-style-type: none"> • SRs are conducted by working parties of civil servants from several ministries and external experts under the chairmanship of a prominent person who does not bear responsibility for current policies. • All SRs are supported by a special unit in the MoF which provides the secretariat of all working groups. In the working parties there is no right to veto any policy option proposed. • The spending review procedure is supervised by a committee of high-level officials of the central ministries (including Prime Minister's Office, Finance, Economic Affairs, and Interior and Kingdom Relations). • The reports of all spending reviews are published and made available to the public and political parties. In review rounds preceding elections they are published before the start of electoral campaigns. 	<ul style="list-style-type: none"> • 10 to 15 interdepartmental reviews undertaken each year (the number of reviews fell during the 2000s to 3-5 each year), but in 2010 some 30 SRs took place. 	<ul style="list-style-type: none"> • Decision making on options described in the SR reports is integrated in the budget process. • The in-coming cabinet has used recommendations from the spending reviews as input for the government programme.

Table 7.3. Key features of national practices (*continued*)

Country	History	Review topics and coverage	Organisational set up and key actors	Number of SRs	Linkage with the budget
UK	<ul style="list-style-type: none"> The SR practice was introduced in 1998. 	<ul style="list-style-type: none"> The SR process focuses on discretionary spending, which covers around 60% of total spending. This is the part of the budget that is subject to the fixed multi-annual ceilings (“Departmental Expenditure Limits, DEL). The remaining 40% is taken up by “Annually Managed Expenditure” (AME) which includes social security, interest, and other items of mandatory spending, and is allowed to fluctuate to provide for automatic stabilisation. The aim of SRs is to support the biennial revision of the expenditure framework and ministerial ceilings. For that purpose the SRs are supposed to: <ul style="list-style-type: none"> to reallocate money to key priorities, change policies so that money is well spent, ensure that departments work better together to improve services, and weed out unnecessary and wasteful spending. 	<ul style="list-style-type: none"> SRs are produced by various types of working groups: some exclusively composed of Treasury officials, some of mixed composition. External experts and prominent personalities from the public and private sector are often invited to participate or chair the working groups. The completed reviews are discussed between the Chief Secretary of the Treasury (responsible for the budget) or the Chancellor of the Exchequer and the line minister. 	<ul style="list-style-type: none"> 6 rounds of SRs took place in the UK since the introduction of this practice in 1998. 	<ul style="list-style-type: none"> The SR process is explicitly linked to the setting of departmental expenditure limits on a periodic basis. In 2010 the comprehensive SR was used to distribute large-scale expenditure reductions planned over a five-year period across the various ministries.

Rationale of the reform

A spending review (SR) is a mechanism that aims to overcome the fundamental asymmetry of the budget process. This asymmetry consists in the fact that line ministers have incentives for making good proposals for new spending (the better the proposals the larger the chance of adoption) but have no incentives to put forward good proposals for new savings (for the same reason: the better the proposals the higher the chance of adoption).

One method to overcome this asymmetry is to impose strict portfolio ceilings, which force line ministers to put forth good savings proposals to compensate for setbacks and new spending initiatives. However, this mechanism does not work at the time the ceilings are established or adjusted. So at these occasions there is a need to develop options for savings outside the regular budget process. A SR is a tool that provides for that need.

Spending reviews allow for developing saving options in co-operation with line ministries but without giving them a leading and decisive role. Therefore one of the key features of SRs is that this process is centralised, and that the Ministry of Finance (or Prime Minister's Office) holds final responsibility for the SR procedure.

Need for a comprehensive legal framework

In order to be an efficient tool of financial management and reallocation the SR practice needs to rest on a comprehensive regulatory framework. Formalising key features of the procedure provides it with the status of a regular foreseeable exercise and reduces the need for ministries of Finance to “reinvent” the procedure with each review (as is the case in Denmark).

It is also important to promote SRs as a focused process. It implies that a SR should lead to concrete, elaborated saving recommendations to be used in the budget process. It also means that the SR process and its outcomes should be embedded in the budget cycle. Without this link with budget formulation SRs cannot produce the expected impact on expenditures and programme efficiency and effectiveness. Options to increase expenditures should not be allowed in SRs. The required amount of savings to be developed by a SR must be fixed in the regulation.

To ensure the process is sustainable over time, and to avoid that the procedure will gradually fall victim to ‘reform fatigue’ (as has happened in Australia and Canada), SR exercises should be conducted on a prescribed periodic basis. This can be ensured in two ways. In view of the required link with the setting of expenditure ceilings, SRs may be set up as an annual or periodic exercise. If the expenditure ceilings are set or extended annually, as is the case in most OECD countries, SR can be conducted on a selective basis, so that every year a limited number of reviews are conducted. In this case it is important to ensure that all policy areas are reviewed at least once in every cabinet period. Alternatively, if the expenditure ceilings are set every two or three years or only once in every cabinet period, as is the case in the UK and the Netherlands¹⁹, SR may be set up as a triannual or quadrennial exercise. In this case it has to be ensured that all policy areas are reviewed simultaneously. In both cases the effect is that each separate policy area is not reviewed more than once in every cabinet period.

Role of the ministry of Finance

Another important feature of the SR procedure is to promote pro-active participation of both the Ministry of Finance and of line ministries in the process. The experience of the Netherlands and the UK reflects a certain tendency to a wait and see attitude of Finance representatives which may diminish their impact on the SR reports.

To make the collaboration between the Ministry of Finance and line ministries more balanced, Ireland has introduced a "court like style" process in its one off spending review exercise of 2008. In this approach each line ministry was invited to submit an evaluation paper in advance of the meetings of the SR team. The purpose of the evaluation paper was to give line ministries an opportunity to outline possible savings options and the impacts on outputs and outcomes. In parallel with this process, the Ministry of Finance prepared their own evaluation papers with included options for expenditure and staff reductions. Both sets of evaluation papers were considered by the SR review team. Subsequently the team produced its own savings options, making use of all information thus obtained. This "accusatorial" rather than "inquisitorial" process puts responsibility on the Ministry of Finance to develop its own set of workable savings options, and allows them to include lessons from other government departments who have successfully cut operating costs or redesigned policies.

Feasibility of the reform

As there is no single blueprint for establishing a successful SR procedure and country models differ, many factors should be considered and tailored to the national institutional and regulatory context and established practices. In order to succeed, the key concern in institutionalising the SR procedure is to make SR as focused as possible, meaning that they must lead to concrete and elaborated saving options to be used in the budget process.

It is equally important to anchor in law the aims of a SR and a clear set of procedural instructions:

- mandatory savings options; prohibition of options leading to additional spending;
- participation in the review teams: experts from Ministry of Finance, line ministries, Prime minister's Office and external experts;
- appointment of an independent chairperson (who do not carry responsibility for the policy area);
- establishment of a steering group of senior officials of central ministries tasked with supervision;
- the criteria for subject selection and the frequency of SRs;
- exclusion of a veto right on options to be introduced in the reports;
- publication of the terms of reference and of the reports, except in special cases (for instance reports on security organisations);

Anchoring these instructions in law is important for the effectiveness of SR and for the sustainability of the SR procedure over time. A strong SR practice may require creating a spending review unit within the Ministry of Finance to support the review process. It has to ensure that the reviews are conducted in a timely manner and that they remain focused on questions that lead to saving options that can be used in the budget process.

Notes

1. To be reduced to 120 in 2015.
2. Since 2007 reduced to 160 line items.
3. The term “line item” means here the lowest level of the budget classification that is used for authorisation purposes. From the legal perspective line items mean that ministers cannot shift resources from one line item to another or can only shift them under strict conditions described in the budgetary legislation. The term “appropriation” is used for the expenditures (outlays or commitments to incur obligations) that are authorised in the line item.
4. An institutional classification subdivides expenditures according to the organisational structure of the government and the ministries.
5. An economic subdivides sets expenditures according to economic character as defined in the national accounts, such as compensation of employees, intermediate consumption and subsidies.
6. A functional classification subdivides expenditures according to the purpose, such as defence, justice and public order, or social protection
7. See Chapter 2 and the Glossary for the distinction between administrative and programme expenditure.
8. Administrative budgets should in principle include administrative investments (investment in government buildings etc. as opposed to programme investment such as infrastructure). In practice, only current operational expenditures are kept separate in countries that have introduced a programme classification.
9. It is sometimes thought that a fixed expenditure framework resembles in this respect a (permanent) expenditure rule (as a fiscal rule), but this is not necessarily the case. Examples of expenditure rules are the requirement that total expenditures cannot increase from year to year by more than the GDP growth rate of (currently promoted by the EU) or that expenditures cannot exceed a certain percentage of GDP. Expenditure rules of these types do generally not lead to a strict separation of expenditures and revenues and are therefore less conducive to automatic stabilisation.
10. In countries that use an MTEF, the fiscal rule becomes irrelevant once the MTEF is decided. However, the EU rules have a supranational character. This is also true for the EU Medium Terms Objectives (MTO's) that come into force if a country does not comply with the EU fiscal rules. In this situation two approaches are possible. In the Netherlands the MTEF is revised so that it complies with the EU rules or objectives. This happened several times in the years after the global financial crisis and implied deviations from the fixed character of the Dutch framework. In Sweden the MTEF remains in place, but EU fiscal rules may imply that the ceilings of the MTEF cannot fully be filled up with expenditures.
11. For instance in the Netherlands tax relief is possible under the current framework if the budget is expected to be in surplus in all years of the framework and moreover if the deficit and debt limits of the EU Stability and Growth Pact (SGP) are respected. If these conditions are met, one fourth of the excess tax yield over to the trend estimate can be given back in the form of tax relief (the rest being used for debt redemption).

12. In addition EU Stability and Growth Pact (DGP) requires Eurozone countries to revise their expenditure frameworks or tax policies in order to comply with the EMU deficit requirements of the GDP. The financial crisis has pushed many OECD countries over the GDP thresholds in the last few years. Many of these countries have now embarked on revision of their expenditure frameworks in order to restore their public finances.
13. For the analysis of budgetary decision-making it is important to distinguish between programme investment and administrative investment. Programme investment is aimed at the provision of capital goods that are used by the citizens: mostly infrastructure for transport and ICT. Administrative investment is aimed at the provision of capital goods that are used by government, mostly government accommodation and facilities.
14. Administrative independent agencies are known in the Netherlands as “*Zelfstandige Bestuursorganen*” (“Autonomous Government Organs”), see Reform 4.3.
15. It seems reasonable that the minister is not held accountable for the operational management of public non-profit institutions tasked with service delivery (universities, museums, etc.), since they have their own procedures of accountability and supervision.
16. In the Netherlands agencies have no other costs than operational costs. In other countries that is not the case (for instance in Sweden, see Reform 12.2).
17. The two main components of operational expenditures are wages and procurement of goods and services (see glossary).
19. The British SRs used to be undertaken periodically in line with the update of expenditure ceilings (every two or three years). The Dutch SRs used to be undertaken every year on a selective basis, but currently there is a tendency to limit the number of annual SRs and to organise a more comprehensive round of SRs prior to parliamentary elections.

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Chapter 8

Human resource management

Human resource management includes the tasks of recruitment, career development, pay (salaries and pensions), training and senior civil service management. Traditionally, two models of standard setting for human resource management are distinguished: the career based model and the position based model. The differences between both models concern mostly the tasks of recruitment, career development and pay. In the career based model the major decisions in these areas are taken by the government in consultation with the trade unions, whereas in the position based model there is more room for market incentives. Remedies for disadvantages attached to the more extreme versions of both models currently lead to a certain convergence.

In the area of training, there is in all participating countries a trend towards more extensive on the job training, which may be organised within the government or outsourced to commercial training institutes. In the area of the top civil service, there is a trend towards special standards, including appointments for a fixed period; special recruitment procedures; emphasis on a variety of experience and leadership skills; and a flexible remuneration system.

As to the organisation of human resource support services, the current trend goes in a direction opposite to that of the New Public Management era, namely towards centralisation: human resource units are moved from sectoral divisions to central human resource directorates in the ministries, and from the latter to shared services centres and directorates in a central ministry (Interior, Finance).

The chapter presents five reforms that offer best practice examples of the recent trends in human resource management and that can lead to substantial savings. All reforms but one are relevant for all participating countries, regardless whether they adhere to the career based model or the position based model. One reform, which concerns more efficient standards of pay-setting, is mainly relevant for countries that are close to position based model of human resource management.

Introduction

Human resource management

Human resource management is decision-making about the use of the operational means of human resources or personnel. In government, like in the private sector, this task is carried out by managers. Managers are supported in this task by human resource support services, which may be centralised in a single ministry, for instance the Ministry of the Interior, or of Public Administration, or decentralised to ministries and agencies. Within ministries there is usually a human resource unit for the entire ministry under the permanent secretary, but there may also be devolved units under division and agency heads.

Like for other support services there are also units that set standards for human resource management, firstly for the whole of central government or even general government, and secondly for ministries. Permanent secretaries are usually the devolved standard setters for ministries and their subordinate agencies.

Human resource management includes the following tasks:¹

- Recruitment ;
- Career development ;
- Pay (salaries and pensions) ;
- Training ;
- Management of the senior civil service.

Central and de-central support services assist managers in each of these tasks and are usually organised in specialised sub-units for each or more of these tasks.

Standard setting for human resource management includes the issuance of government wide or ministerial regulations for each of the tasks as well as general regulations covering all tasks.

Government personnel may be divided in a formalised civil service and contract personnel. If there is a formalised civil service, it is usually regulated by public (administrative) law, rather than by civil law. Civil service law is per definition different from civil labour law, although there is a trend towards convergence in recent years.

Career and position based standards

Features of the career and positions based models

Standards for human resource management differ widely between OECD countries and also between the countries participating in this study. Traditionally two models of standards are distinguished: the career based model and the position based model. Self-identification among the countries participating in the study led to the following result²:

- Career based model: Austria, France, Ireland, Spain.
- Position based model: Australia, Canada, Denmark, Finland, the Netherlands, New Zealand, Norway, Sweden, and UK.

In practice human resource standards of many participating countries have hybrid features that distinguish them from the archetypical models. Nevertheless it is useful to analyse standards of human resource management in terms of the polar cases since such analysis sheds light on various interesting aspects of human resource management. For the analysis in this introductory section, France and Sweden have often been looked at as examples that come close to the polar cases, France for the career based model and Sweden for the position based model.

The differences between the models mostly come to the fore in the areas of recruitment, career development and pay. The models do not necessarily differ in the areas of training and the management of the top civil service. Of course there are large differences between countries also in the latter areas, but these are not necessarily connected with the differences between the models.

The models can be broadly described as follows:

1. Recruitment

In a *career based model* there is always a formalised civil service, regulated by public law. Recruitment for the civil service is organised government wide by occupational groups. Recruitment is aimed at candidates who have finished their education but who do not necessarily have earlier job experience (although candidates with previous job experience may take part). Candidates are required to take part in government wide competitive examinations (in France: the “*concours*”) that focus on education and skills required for successful performance in the jobs that belong to the occupational group. The number of candidates allowed to pass the examination is dependent on the estimated needs for recruitment in the occupational group. In order to make this possible a form of workforce planning is required that takes into account the future demand for jobs in the occupational groups. Successful passing of the competitive exam does not give an immediate right to be recruited, but the procedure aims to make the group of successful candidates small enough to justify the expectation that every successful candidate will be recruited within a reasonable waiting period. Ultimate recruitment decisions are taken by senior managers.

In a *position based model*, all vacant jobs are open to competitive applications. There is not necessarily a formal civil service. Employment contracts for all civil servants are based on civil law. Sometimes rules are in place that make it possible that internal candidates (either from the ministerial division or agency concerned or from other ministries or agencies) to apply first and that the vacancy is externally advertised only if no suitable internal candidates have been found. Other rules may allow horizontal shifts (without grade increase) by managerial decision without a competitive application procedure. Recruitment decisions are based on criteria of qualifications (education, skills and experience) and merits. The latter, which include performance in previous jobs, are usually assessed in panel procedures. Ultimate recruitment decisions are taken by senior managers.

2. Career development

In a *career based model*, there is a grade/scale grid in place for every occupational group. Promotion to next steps is based on seniority and performance, the latter to be assessed by managers, in principle on the basis of a formalised periodic assessment procedure, which needs to be documented. Promotion to next grades is based on

managerial assessment, in principle on the basis of competitive procedures that are open to internal candidates from the occupational group in the entire government.

In a *position based model*, all vacancies are open for internal and external candidates, although internal candidates may have a right of first application and horizontal shifts may be allowed without competitive procedures. There is no difference between recruitment decisions and promotion decisions (see above).

3. Pay

In a *career based model* pay is determined by grade (job responsibility), scale (years of experience) and the prevailing grade/scale grid for the occupational group. Pay and pensions are partly determined by government wide negotiations with the trade unions and partly by devolved negotiations between designated managers and trade unions for the occupational groups. Government wide negotiations usually concern job security, annual across the board increases or limits on increases (for instance maximal increases or in times of austerity: no increases) and other general working conditions. Negotiations at the level of occupational groups concern revision of grade/scale grids for occupational groups, occupational working conditions and variable pay components (special experience and skills, individual household conditions and performance). Agreements with the trade unions are inserted in regulations and apply generally to members of the occupational groups, regardless whether individual employees are members of unions. Pay and pension conditions for non-civil service personnel may be determined by separate negotiations with relevant trade unions according to the prevailing procedures for industrial relations in the private sector.

In a *position based model* pay and pensions are decided by managers and trade unions, usually in a layered procedure. At the government wide level there may be a central employers agency, as is the case in Sweden (see further Reform 8.3), or a limited number of employment sectors, each represented by a single senior manager. The employer agency or the sectoral managers negotiate with the trade unions about job security, pension systems, parameters for devolved pay negotiations and other general working conditions. Devolved negotiations take place at the level of ministries and agencies or even at the level of managers of ministerial and agency divisions. Devolved negotiations may take place with the local trade unions or even with individual employees (the latter is increasingly the case in Sweden). Agreements with the trade unions are included in regulations and apply generally to all government personnel or to all personal of the ministry, agency or division, regardless whether individual employees are members of unions. Since there is no grade/step grid, ultimate decisions are entirely determined by labour market conditions, qualifications (education, skills, experience) and merits (including performance). Negotiations on pay and pensions are based on civil labour law.

Trends of convergence

Of the countries included in the study none has self-identified its model of human resource standards as “hybrid” although the opportunity to do so was given. Nevertheless there have been tendencies in all countries to move away from the features of the polar cases, including in France and in Sweden, considered here as being close to the polar cases. Thus far this does not mean that the models as such are abandoned by the governments that adhere to them. It rather means that some of their features are being softened or made more flexible.

This can be illustrated by the case of France. It is felt in France, as well as in other countries adhering to the career based model, that important advantages of this model are:

- In recruitment: that it ensures the objectivity of the competitive entrance model (“*concours*”), which excludes corruption, patronage or clientelism.
- In career development: that it leads to more job mobility within occupational group while maintaining job security.
- In payment of salaries/pensions: that the fixed grade/scale grid leads to more objectivity and more transparency about pay and less dependence on (local) trade union power.

However, it is currently felt in France that the model has also disadvantages, which require reforms in order to modernise the model and adapt it to new challenges that the government is facing (OECD, 2012b). Some of such disadvantages are:

In recruitment: the practice of competitive entry exams is too much focused on knowledge and analytical skills and does not take into account “soft skills” (social skills, communicative skills, leadership skills), nor requirements that are tailored to narrow groups of jobs (ICT skills, technical skills, mental conditions such as stability, stress resistance, etc.). In order to remedy this, the entry exams need to be reformed and possibly complemented with job focused panel procedures for successful candidates.

- In career development: occupational groups, such as represented by the French “*corps d’État*”, may be too narrow, impeding mobility rather than facilitating it. In order to remedy this, the occupational groups have to be broadened and merged including merger of the “*corps d’État*”.³
- In pay: grade/scale grids may be too detailed and too rigid, making it impossible to adjust pay rapidly to changing market conditions, new qualifications and merits of suitable candidates; this may in turn lead to wide spread use of variable pay, which may pose a risk of corruption, patronage, clientelism, and makes the entire pay structure less transparent. In order to remedy this the grade/scale grid may need to be simplified and its application may need to be more flexible (allowing faster rise through the scale, easier promotion to higher grades, less emphasis on seniority and more on other criteria such as labour market conditions, relevant experience and performance).

In the countries that adhere to the position based model, adjustments are also being considered. This can be illustrated by the case of Sweden. It is felt in Sweden, as well as in other countries adhering to the position based model, that important advantages of the model are:

- In recruitment: that the panel procedures take into account all relevant market criteria in relation to specific jobs: market conditions as well as qualifications and merits.
- In career development: that all vacancies are in principle open to internal and external candidates, so that the best candidates can be appointed.
- In pay: that maximal discretion is given to managers, so that pay can easily be adjusted to market conditions, qualifications and merits. Moreover the layered system of negotiation with the trade unions is efficient in that only general aspects

of pay and pensions are negotiated at the central level; moreover local employers (ministries, agencies and division heads) are supported by experts from the central level (employer agencies or sectoral managers and their staff).

However, it is currently felt in some of the countries adhering to the position based model, including Sweden, that the model has also disadvantages, which require reforms in order to modernise the model and adapt it to new challenges that the government is facing. Some of such disadvantages are:

- In recruitment: panel procedures lead to high transaction costs since general qualifications have to be assessed in the recruitment procedure for each individual. This implies the loss of economies of scale. This can partly be remedied by use of shared human resource services for recruitment.
- In career development: that mobility is limited if internal candidates have little priority over external candidates and sometimes unfair, when internal candidates have to be compared with external candidates about whom less is known. Moreover, job security is inherently lower, which in turn may lead to informal practices in order to keep officials employed that run counter to the rationale of the model, and which puts more emphasis on the role of the local unions, that represent redundant employees. This can partly be remedied by more emphasis on redeployment and training facilities and stricter conditions on redundant personnel to accept alternative employment.
- In pay: the large discretion of managers may lead to unjustified differences between pay between ministries and agencies and between ministerial and agency divisions. This may in turn lead to inefficient competition between employers within government. Furthermore, the devolvement of negotiations strengthens the position of local trade unions, even if pay negotiations are fully individualised, since employees will often seek support and advise in an otherwise unequal bargaining situation. This leads to a high degree of unionization that runs counter to the general trend of decreasing unionisation and that may not be efficient from the perspective of transaction costs. These disadvantages can partly be remedied by guidelines about pay, which comes down to a resurrection of rudimentary grade/scale grids.

Remedies for particular disadvantages for the polar models lead to a certain convergence of the models: shared support services for recruitment procedures, inclusion of soft skills in recruitment procedures, formalising priority rules for internal candidates, more emphasis on redeployment and training facilities, stricter conditions on redundant personnel to accept alternative employment, and pay guidelines on the basis of basic grade/scale grids. However, in spite of these tendencies towards convergence, there remain essential different features of both models that thus far are not given up by the countries that adhere to them. These features concern the openness of application procedure for vacancies to external candidates, the presence of a grade/scale grid and the discretion of managers in ministries and agencies in pay-setting.

Other standards

4. Training

Standards on training are not necessarily related to the career and position based models human resource management. However, the training requirements are typically different in the countries adhering to each model. This is the case because in the career based model recruitment is based on occupational groups, which leads to the emergence of educational establishments outside the State that aim to prepare students for recruitment in the civil service (for instance the *Grandes Ecoles* in France). As a consequence, in countries which adhere to career based models, education and training tends to take place to a larger extent before recruitment, whereas in countries adhering to a position based model, more needs to be done after recruitment. However, in both models, training of employed personnel is an important task and this task has become increasingly crucial over the last decades now that working methods and required skills are changing so fast as a consequence of new demands on government, new production methods and new technical developments (including ICT).

Training of employed personnel takes two forms: insourcing and outsourcing. In-sourced training takes place in government schools and academies. Most countries have police academies, academies for penitentiary personnel, various kinds of schools for military personnel, academies for diplomacy, etc. Many countries have academies for public finance, accountancy, auditing, legislative drafting, administrative law, human resource management. In-sourced training facilities are human resource support services and can often be shared between ministries and agencies.

Outsourced training takes place in educational establishments outside the State, but is financed by budget holders (senior managers holding a budget and a mandate to enter into contracts on behalf of the State). Outsourced training tends to be more efficient if the number of employees to be trained is small and if the training needs are more job-specific.

Standards on training determine which personnel should take part in trainings in which stage of their career and may also establish a right of employees to be trained for their current or potential future jobs.

5. Management of the senior civil service

The senior civil service in a country consists of the top management positions of the permanent civil service, formally or informally recognised as a separate group of civil servants (Kuperus, Rode, 2008). Of all countries included in the study only the Netherlands and the UK have formalised the membership of the senior civil service group in separate regulations, but in all other countries there are policies in place that specifically apply to senior civil servants and that can be seen as standards for the management of the senior civil service.

Typical features of human resource standards for the senior civil service are:

- Appointments for a fixed period (possibly extendable by one additional period);
- Special inter-ministerial appointment procedure under the leadership of the Prime Ministers' Office, with a strong emphasis on performance assessment in previous positions;

- Emphasis on variety of experience in policy development, policy execution and different ministries or governments (including local government) in the appointment procedure;
- Leadership skills are explicitly and separately assessed;
- Flexible remuneration system that makes it possible to adjust pay to market conditions (if there is grade/scale grid in place by wide discretion on scaling).

For the current study many countries reported a trend to put more emphasis on separate standards for the senior civil service as a tool to improve the quality of the civil service.

General civil service regulations

Apart from standards that relate to the separate tasks of human resource management there are government wide standards that relate to civil service or government personnel as a whole. These standards often apply wider than central government and cover all levels of government (including state and local government).

In the countries included in the study civil service or general personnel regulations mainly include the following subjects:

- Procedures of appointment, promotion and job change;
- Procedures of performance assessment;
- General principles of pay-setting and pay (based on qualifications, merits and market conditions);
- Working hours, holidays and work leave (parental leave, study leave, special forms of leave for political duties, trade union duties, care tasks for close family, etc.);
- Work environment and preventive health care;
- (Second pillar) pensions;
- Social insurance arrangements on top of, or in place of, regular social insurance regulations (pay and other benefits during sick leave, benefits relating to work related injuries, child benefits, disability and unemployment benefits and benefits for dependent family members in case of decease);
- Freedom of expression, definition of confidential information that employees are not allowed to publish and protection of whistle blowing.

The organisation of support services

The organisation of human resource support services is traditionally divided over central units (divisions or agencies) under the Ministry of Finance or the Ministry of the Interior or Public Administration on the one hand and units under the permanent secretary of the ministries on the other hand. Some training facilities (schools and academies) are usually organised under the central ministry. The management of the senior civil service is also a task of a unit under the central ministry.

The division of tasks is partly dependent on the career or position based model of standard setting. In a career based model, support services for recruitment (the

organisation of the competitive examinations) are largely organised government-wide under a central ministry.

Other support services used to be decentralised to ministerial human resource divisions under the permanent secretary: the organisation of recruitment in countries that adhere to the position based model, support of assessment procedures; personnel administration; travel administration; leave and sickness administration; payment of salaries and pensions; and organisation of training facilities that are not organised government wide.

Support units both at the central and de-central level often also provide support to standard setting tasks, next to units that are exclusively dedicated to standard setting.

In the 1990s many de-central support units in the ministries were further decentralised to ministerial divisions and agencies, partly in the context of reforms inspired by the ideas of New Public Management. However, in recent years the trend goes in the opposite direction: centralisation of ministerial support services in a single ministerial unit under the permanent secretary, and concentration of ministerial support service in shared service centres. The latter trend has in principle large potential for efficiency gains. Successful service sharing imitative in the countries included in the study concern: recruitment (regardless whether the country adheres to a career or position based model), payment of pensions and salaries, personnel administration, travel administration, leave and sickness administration, payment of salaries and pensions and training facilities (including merger of schools and academies).

Reforms of this chapter

Human resources support services have increased rapidly in the previous decades. In this light it is understandable that these services are in the focus of current consolidation efforts.

Most of the reforms described in this chapter are selected in view of their substantial savings potential and may thus provide inspiration for these efforts.

Implementation of these reforms does not require a choice between the career based or position-based model of human resource management. In general, there is no evidence that one model is more efficient or less costly than the other. For instance, central recruitment in the career based model may be less costly than vacancy based recruitment in the position based model, but on the other hand the absence of automatic pay rises related to seniority may constitute a cost advantage of the position based model. Four reforms are relevant, regardless whether a country adheres to the career based or position based model or moves in the direction of convergence. One reform is only relevant if a country is close to the position based model (Reform 8.3 more efficient pay-setting).

The first reform leads to savings through service sharing (Reform 8.1), the second through limitation of central and de-central standards in several areas of human resource policy (reform 8.2), the third reform through more efficient standards for pay-setting (Reform 8.3) and the fourth through reduction or abolition of variable pay (Reform 8.4).

One reform concerns the strengthening of standards concerning the senior civil service (Reform 8.5). The latter reform does not necessarily lead to savings but may contribute to the quality and impartiality of the civil service and may be interesting for countries that consider reforms in these areas.

Reform 8.1. Human resource support service sharing

Characteristics of the reform

This reform consists in support service sharing in the area of human resource management. This requires the establishment of shared service centres in all areas of human resource support which are conducted at the level of ministries, agencies or divisions: recruitment, career development, salary and pension payment and training.

Such shared service centres are government units that provide support services to more than a single ministry of central government. Pooling usually implies transfers of personnel to the shared service units, and staff cutbacks in decentralised units.

Where did it occur?

Many governments have recognised the benefits of shared service arrangements for human resource management. Denmark, the Netherlands and the UK are among the most advanced countries in this area.

Analysis

Benefits

The benefits of shared service arrangements in the area of human resource management, as in other areas of support service delivery, are:

- cost savings through concentration, process standardisation, and economies of scale;
- enhancing service quality;
- achieving synergy and facilitating a stimulating working environment for specialists.

Top-down and bottom-up models for creation of shared service centres

In the countries of the Value for Money study there are two distinct models for the creation and use of shared service centres: the top-down model and the bottom-up model. In the top-down model, the use of the shared service centre is imposed by Cabinet decision, and the personnel that provides the support services is transferred from the line ministries to the shared service centre. In the bottom-up model, the use of the shared service centre remains voluntary for the line ministries, but there may be incentives in place to stimulate use, such as personnel reduction operations (sometimes specified for support services) or permanent automatic productivity cuts. Austria, Denmark and Finland report that they follow a top-down approach. The Netherlands, Norway and Sweden report that they follow a bottom-up approach, Canada a combination of the two.

Moreover, as a previous Value for Money study (OECD, 2011:76) shows, there is a clear connection between the use of the models and the concentration of shared service centres. The three countries that use the top-down method have created their shared service centres in one ministry: all three in the Ministry of Finance. The three countries that use the bottom-up method, and Canada that uses both methods, all have a number of shared service centres spread out over a number of ministries.

Which human resource services can be shared?

The nature of services supplied by a shared centre is determined by customers' needs, i.e. by the needs of ministries and agencies that pool services. These needs are decided by the Cabinet in the top-down approach and by ministries themselves in the bottom-up approach. The challenge of this reform is to achieve an optimal transfer of services to the shared service centres so that the benefits are fully achieved and more ministries and agencies have incentives and interest to use the shared service arrangements.

The following items are often included in the competencies of shared centres:

- organisation of recruitment;
- support for performance assessment;
- salary and pension payment;
- payroll changes (including change of status, for instance promotion, maternity leave);
- personnel administration;
- absence monitoring (leave and sickness);
- employee welfare support;
- organisation and monitoring of training.

The set of tasks to be performed by a shared service centre differs from country to country depending on the central government institutional features, development of shared centres and the approach to introducing shared service arrangement (top-down or bottom-up). The general tendency is however, that the practice of service sharing increases automatically once the cost and quality benefits flowing from economies of scale become clear to potential clients.

Risks associated with pooling support services in shared centres

The question whether the benefit of economies of scale (by bringing service delivery together in one place) outweighs the benefits of keeping human resource services at the ministries, agencies and divisions, hence close to the clients, ought to be answered by evidence, in particular concrete experiences. The latter increasingly show that when well designed, a shared service centre can increase the quality of services and reduce costs. Some risks should however be considered.

Firstly, it is important not to create an oversized, rigid institution that will not service the interests of clients, but create additional obstacles to effective and efficient human resource management. To mitigate this risk it is important to focus on needs of ministries when creating a centre and on the benefits expected from sharing.

Another possible risk is attached to the creation of monopoly suppliers of those services within the public sector, particularly as large ICT systems are involved (risks of project failure or malfunctioning of existing systems). This is not to say that monopoly supply should be avoided. By its nature, government consists almost entirely of monopoly suppliers. The argument is rather that if monopoly is optimal from the point of view of quality and economies of scale, it should grow gradually to the extent that its benefits are perceived by client units. Moreover, for many support services it is not clear

that the optimal scale of production is the entire central government, or even the entire general government (including subnational government). A scale that is too large may lead to bureaucracy and lack of responsiveness to client preferences. Only tailoring the centre to the needs of ministries and to benefits expected from its creation and considering specific circumstances of each concrete government can help mitigate this risk and achieve an optimal concentration of support services in government-wide units.

Denmark

Denmark has adopted a top-down model of service sharing. Human resource management services have been pooled in the Agency for Governmental Management (*Moderniseringsstyrelsen*). The Agency is subordinated to the Ministry of Finance and responsible for supporting and developing administrative processes throughout the entire government. Its clients include 155 of the government's 176 ministries and ministerial agencies, as well as 250 public non-profit institutions, such as schools. Together with human resource services, *Moderniseringsstyrelsen* provides services in other areas of operational management (organisation, finance, communication, facilities, ICT). The objective of *Moderniseringsstyrelsen* is to ensure efficiency and sound economic management.

Moderniseringsstyrelsen provides shared services in the following areas of human resource management:

- personnel administration;
- recruitment;
- competency development;
- reducing sickness absence;
- welfare programmes and monitoring;
- performance management;
- salary and staff statistics.

In addition, *Moderniseringsstyrelsen* is charged with human resource management of senior officials. It serves as a secretariat for recruitment of senior managers, for measuring and monitoring organisational and individual performance, developing skills and senior executive talent in the government, running the programme "Talent management". It is also responsible for European co-operation in human resource management.

A special division of *Moderniseringsstyrelsen*, namely its Centre for Systems and Personnel, takes care of payroll systems. It operates and develops the salary payment system *Statens Lønssystem* (SLS). SLS is a payroll system used to calculate pay for the majority of state employees, including civil servants and contract staff. The system is online for both reporting and inquiries. SLS is linked with pension funds and the tax service. Moreover, the system is used to provide a variety of statistical information, such as information on employees' job status, which is part of EU statistics. It also includes a wide range of salary data. Almost all agencies of the government in Denmark use this central payroll system that has some 1 750 users. Next to the payroll systems, SLS also runs the accounting system Navision in support of financial management.

Recently *Moderniseringsstyrelsen* has implemented a fully electronic travel and expense management system. The system will produce expense reports for 90 000 to 110 000 trips annually. The system is expected to generate considerable savings. As a recognition of its success, *Moderniseringsstyrelsen* was awarded Denmark's national digitization prize for cost savings achieved through automation and process improvement⁴.

The United Kingdom

Since the Gershon Review in 2004, the UK central government has recognised the potential benefits of shared support services, through:

- reducing the cost of back office support services via asset sharing and economies of scale;
- driving service excellence by allowing the department to focus on core objectives;
- increasing operational efficiency through improvement of management information and benchmarking of organisations, which in turn could potentially improve performance.

Several ministries have pooled a number of support services which have enabled a “joined-up” approach to managing their corporate functions. A number of shared service centres have emerged that have delivered some savings. However, until 2012 the development of service sharing has not been systematic and the pattern of service sharing has become complex.

With the “Next Generation Shared Services” programme that became operational in 2012, a new approach to service sharing has been initiated. The mission of this programme is to deliver a significant reduction in costs through standardisation of processes and common use of IT, buildings and human resources. This is the most comprehensive plan for shared services ever produced by the government bringing together all ministries. In order to execute the current programme five centres for transactional services (finance, payroll, human resources, and procurement) are established creating the necessary infrastructure by the end of 2013, with full delivery of the programme by 2014 (see Reform 6.3).

In the area of human resources and payroll, ministries and agencies will pool the following services:

- employee lifecycle processing (personnel administration);
- first level human resource case management;
- absence (leave and sickness) monitoring and management;
- query handling and resolution;
- payroll management.

In parallel with “Next Generation Shared Services” programme, the UK Cabinet Office has implemented since 2011 another project with the title “Next Generation Human Resources”. The project aims to deliver a responsive, professional human resource service with better business outcomes at a significant cost reduction through the rationalisation of operating models, greater standardisation and the sharing of expertise.

The underlying idea is that human resource services are delivered by four independent shared expert service centres. These centres are Employee Policy, Civil Service Learning, Resourcing and Organisation Design. The aim is to reduce the ratio of human resource staff to civil servants from the current average of 1:50 to a ratio of 1:100 and create “rationalised, simpler and standard” policies that all departments can use. The focus is on developing standard policies and electronic solutions and using learning products and services from outside the civil service.

The Netherlands

In the Netherlands, the policy of service sharing has two separate tracks. The first track consists of the establishment of new shared services centres in the Ministry of the Interior and Kingdom Relations. Presently, there are three such centres: one for salary and personnel administration (P-direct), one for human resources and facilities (post/mail, security, reproduction, catering, etc.: Work Company) and one for archives. The build-up of these centres was partly based on the transfer of existing ministerial personnel.

The second track consists of *ad hoc* downsizing operations. These operations have to provide the incentives for task transfer and to produce savings.

In the cabinet period 2007-2010 an *ad hoc* downsizing operation on the number of employees was carried out. It consisted of a cut of administrative budgets, accompanied with personnel reduction targets (“double lock”): minus 25% for support services. However, it still left the ministries and agencies substantial freedom. Although the cut was differentiated for types of tasks (and thus dependent on the task mix of each ministry), it was imposed on the entire administrative budget and the entire employment of the ministry including its agencies. Each ministry was free to fill in the cut in a different way than supposed in the calculation of the target (for instance, although support services have the largest target, the ministry was free to moderate this percentage if it can realise a larger than supposed cut on policy development for example). At the time of this operation various interlocutors of the Value for Money team expressed doubts about the effectiveness of this operation for better use of the shared service units and producing savings. First, it was said that the target (25% in four years, 6.25% per year) was not high enough to trigger fundamental reconsideration and decisions to transfer tasks to shared services centres. Such a target can also be realised by efficiency measures without any transfer of tasks. This led to a plea for a much higher percentage reduction on support services in the order of 40% or 50%. Second, it was pointed out that the calculation of the target (for all tasks, not only support services) was based on future administrative budgets that included new policies. This meant that efficiency measures could be evaded to the extent that the new policies were delayed or implemented in a different way than supposed. Thirdly, it was pointed out that the calculation of the target (again for all tasks) was based on formal employment numbers that included 5% vacancies. By realising a lower vacancy percentage efficiency measures could partially be evaded.

In the current cabinet period (starting in 2012) the “double lock” approach with separate personnel reduction targets has been abandoned, mainly in view of doubts about effectiveness and monitoring costs, and a new downsizing operation is exclusively aimed at reduction of administrative budgets. Counting up the cuts of the cabinet period 2007-2010, the short lived cabinet 2010-2012 and the current cabinet, the consolidation target on administrative budgets amount to a structural saving of EUR 4 200 million annually in 2018. This is a very substantial reduction that comes down to a personnel reduction of 8-12%. In view of the aim to give priority to front office services, this comes down to a

much higher reduction effort on support services, which in turn will provide a strong incentive for support service sharing.

Feasibility of the reform

As the examples of Denmark, the UK and the Netherlands show there is a large potential for service sharing in the areas of human resource management. The Danish top-down model accompanied by large savings targets has proven to be effective. The Netherlands and the UK started with a bottom up model that left some discretion to ministries and agencies as to the use of the shared services, but have recently also moved to a more compulsory approach. Regardless of the model chosen, the imposition of large *ad hoc* savings targets on administrative budgets of ministries is essential to trigger fundamental reform (possibly next to permanent productivity dividend targets, see Reform 7.5). Such targets can still leave some discretion as to the realisation of the savings.

Reform 8.2. Human resources standard setting

Characteristics of the reform

The reform consists in the limitation of standards for human resource management to the minimum necessary to ensure that the government is a competitive, socially responsible, equal opportunity employer, while sufficient attention is given to cost control.

The reform aims on the one hand at limiting central and de-central rules which can have a stifling effect on human resources practices that seek to respond to business needs in ministries and agencies, and on the other hand at preventing divergence concerning core principles of human resource policy of the government in the areas of competition, social responsibility and equal opportunities. In addition the reform includes concentration of government wide standard setting in a single central ministry (Finance, Interior or Public Administration).

Where did it occur?

Many OECD countries have in place a combination of central and de-central rules of human resource management, but the trend in many countries is toward more centralisation and toward more rules in general (both central and de-central). In the UK and the Netherlands reforms have taken place to reverse these trends and to limit standards, in particular central standards.

Analysis

What should be centralised?

In designing human resource policy for the central government it is crucial to strike a balance between central and de-central standards. Several OECD member countries have reduced central standards (for instance the UK, Sweden, and Australia) so that ministries and agencies have more flexibility in setting employment conditions. Next to competitiveness, social responsibility and equal opportunities, the imperative of cost control is an important factor in striking the right balance.

This reform aims to integrate human resources policy making for the central government as a whole in a single unit in a single ministry, preferably the Ministry of Finance. These rules should be limited to general civil service or government personnel regulation (see the introduction to this chapter) and a minimal set of rules on each of the tasks of human resource management: recruitment, career development, salary and pension payment, training and management of the senior civil service. Depending on ministerial tasks, additional rules may be set by the permanent secretaries of ministries, but de-central rules too, should be kept at a minimum, so that managers avail of optimal room to adjust the use of human resources to their business needs.

Why minimal standards and maximal room for managerial discretion?

The efficiency and effectiveness of public administration and service delivery relies on fostering innovation. More innovative approaches entail greater delegation of responsibility for human resource management to ministries and agencies and to line managers, in order to enable them to develop new ways of working.

Granting authority to line managers has the potential to make the civil service a more attractive employer. Job seekers are better educated and more demanding when it comes to job content and work conditions and opportunities, and public employees are increasingly mobile between the public and private sector. Public managers must be able to respond to their needs and requests.

The Netherlands

The Directorate General of Organisation and Operational Management of the Ministry of Interior and Kingdoms Relations is the central standard setting authority for human resource management in the Netherlands. It is responsible for interdepartmental coordination and harmonisation and general policies for human resources. More specifically its activities include:

- designing, managing, coordinating and supervising human resource policy for the central government;
- transmitting public service values;
- standardising recruitment and appointment procedures;
- designing skills profiles, including setting and monitoring the job classification system;
- providing training;
- promoting diversity.

Overall, these rules have led to a broadly comparable employment framework across all central government staff. Within these rules there is a considerable scope for discretion at the level of ministries, agencies and line managers. The Dutch system of public recruitment is position-based. All vacancies are published, selection panels and recruitment firms are used, and the human resource unit of ministries and agencies shortlists possible candidates. Most posts are firstly opened to internal candidates and subsequently to external candidates if no suitable internal candidates have applied. Recruitment for top management positions follows a special procedure (see Reform 8.5).

The Directorate for Organisation and Operational Management has developed a digital tool for job classification for the whole central government: a system of 52 job descriptions in 8 job families (the system has been optimised and streamlined in the recent past from 30 000 job descriptions). Each job is graded on the basis of required qualifications and merits and there are up to 10 salary steps in each grade.

The UK

In the UK standards are decentralised and reduced to a relatively large extent in comparison to other OECD countries. Regulation of most human resource issues in the UK is delegated to ministries and agencies. The central human resources unit, the Human Resources Board (HR Board), is charged with strategic coordination, including corporate leadership, guidance, designing and overseeing human resource strategy. The HR Board is chaired by the Director General for Human Resources at the Ministry for Work and Pensions.

Standards regarding recruitment, career development, pay and working conditions and performance assessment are delegated to ministers. The allocation of the budget envelope for salaries is set and monitored centrally in the budget process. Standards for the job classification are delegated to ministries. With regard to working conditions, the code of conduct and equal opportunity policies are set centrally, with some latitude for ministries on the latter issue.

Outside the Senior Civil Service where pay is set centrally by an independent pay review body, pay setting in the civil service is delegated to ministries. Therefore they vary from ministry to ministry reflecting their business and workforce needs. Base salaries are set through decentralised collective bargaining. Relevant experience is the most important determinant of base salary for all grades, with qualifications, job content, performance, and seniority also factoring in. Practices with regard to pay increases in the past few years were determined by fiscal consolidation measures. In 2012 the Chancellor of the Exchequer (Minister of Finance) announced that there would be a 2-year pay freeze for all government personnel, with protection for the lowest paid, and that pay increase will average 1% for the two years following the pay freeze.

With regard to recruitment and selection, the UK uses a fully position-based recruitment procedure. Entry into the civil service proceeds through open competition for a position and is subject to audits to ensure recruitment adheres to the established guidelines. The National Vacancy Filling Scheme is used for recruitment. The scheme operates by filling vacancies in 4 stages. The procedure moves to a next phase if the preceding phase has not resulted in the selection of a suitable candidate.

Stage 1: Internal, same grade level moves (no open competition required);

Stage 2: Exclusive 10 day period for surplus staff in all departments at their current grade;

Stage 3: Vacancies advertised to all staff, regardless of grade or department;

Stage 4: External recruitment (severely constrained by a recruitment freeze).

A shared services centre – Civil Service Resourcing (CSR) – provides support to customer ministries, including management of recruitment and vacancy filling campaigns. The CSR maintains the e-recruitment system. In addition it provides advice on and develops assessment tools and methods.

Feasibility of the reform

In many OECD countries there is a large scope for limitation of central and de-central standards for human resource management. The UK and the Netherlands offer good example of limitation of standards to a minimum that is necessary to ensure that the government is a competitive, socially responsible, equal opportunity employer, while sufficient attention is given to cost control. These countries also offer good examples of how government wide standard setting can be concentrated in a single unit under a central ministry.

Reform 8.3. More efficient standards for pay-setting

Characteristics of the reform

This reform consists in the introduction of a two-level bargaining procedure for reaching agreement between government employers and (representatives of) employees about remuneration and other working condition. It means that pay setting matters considered essential for the central government sector as a whole are negotiated and agreed at the central level (for instance, pensions and general coherence guidelines), and matters connected to the business needs of separate ministries and agencies are decided at a de-central level (for instance job classifications and grade/scale grids). A single arm's length agency, in which all government employers work together, provides support to both central and de-central negotiations.

Where did it occur?

The two-level bargaining procedure, supported by a single arm's length agency in which all government employers cooperate, is characteristic for the Scandinavian countries. The clearest and most advanced example is Sweden.

Analysis

Pay setting

The term “pay setting” in the Value for Money study refers to the decisions of officials, usually ministers or agency heads, who ultimately decide on pay for certain groups of employees or for individual employees. Pay is first set when new staff is appointed and when the employer determines the level. An agreed procedure of negotiation regulates when and how pay can be revised.

Practices of pay setting in some OECD countries

Previous OECD studies (OECD, 2007; Rexed et al., 2007) have shown that, in OECD member countries, there exist at least three different models for pay setting:

- The Scandinavian model of two-level bargaining that is described in this reform. An arm's-length “Agency for Government Employers” negotiates and decides on behalf of all government employers on general aspects, and subsequently ministries and agencies negotiate and decide on more specific aspects in the light of business needs.
- The Australia/New Zealand model. Ministries and agencies negotiate and decide in the light of business needs. In order to maintain coherence, binding bargaining

parameters are provided by the Civil Service Commissioner (who is a Cabinet minister).

- The United Kingdom model where ministries and agencies negotiate and decide in the light of business needs. However, all bids need approval from the Treasury (“remit system”). Furthermore, the Cabinet Office can issue binding bargaining parameters. However, in contrast to the Nordic and Australia/New Zealand models, there is no perfect “firewall” between pay setting and budgeting, because the Treasury is (indirectly) involved in the negotiations with the trade unions (via the remit system).

The following tables summarises some answers that Value for Money countries have provided when describing their practices in the area of pay setting.

Table 8.1. Wage bargaining in some OECD countries

	Is there a difference between wage bargaining for the civil service and other public employment?	At what level does wage bargaining take place?	By whom is the government as an employer represented in these negotiations?
Australia	For both groups of employees it is governed by the Fair Work Act 2009. In the Public Service bargaining must also comply with the government’s policy set out in the Government Employment Bargaining Framework that regulates the management of workplace relations in Australian Government employment.	Agency level.	Agency heads.
Austria	No difference.	Increases in salaries for federal civil servants and public employees are negotiated by the Austrian Federal Government with the Public Services Union and subsequently regulated in legislation.	The Ministry responsible for public service takes a leading role in negotiations. The Ministry of Finance and the offices responsible for salary law also take part in the negotiations.
Finland	No difference.	At the central level the Collective Agreement for State Civil Servants and Employees is signed by the Office for the Government and the Ministry of Finance. At the local level collective agreements are handled by agencies.	The Office for the Government and the Ministry of Finance.
Norway	For the civil service rules for wage bargaining are authorised in the General Collective Agreement for Civil Service and the Civil Service Disputes Act. This agreement and act do not apply to contract personnel.	The government enters into collective agreements on behalf of the State with the consent of Parliament.	The Ministry of Local Government and Reform
Spain	For civil servants regulation is agreed with unions prior to its embedment in law. For contracted personnel there is only a collective contract; the outcomes of bargaining are considered as law.	There is a General Negotiating Body for General State Administration that concludes agreements for civil servants and contracted personnel at the central level. At sub-central levels there is General Negotiating Body for civil Servants and Negotiating commissions for contracted personnel.	The Secretary of State, Director General of Civil Service, Deputy Director General for Labour Relations

Source: Responses to Value for Money questionnaire.

Individual pay and wage bargaining in Sweden

Since 1991 Sweden has used a method of individual pay that has replaced the former method by which posts were classified in pay grades. Individual pay is set on the basis of the required qualifications (including experience), merits (including performance) and market conditions.

A method that is increasingly applied for incumbent officials is that the immediate superior evaluates results attained by the employee and his or her performance at the occasion of an annual pay review. The new pay level is then confirmed in a pay-setting dialogue between employer and employee. The employee can be assisted or represented in this dialogue by the local trade union.

The Swedish authorities highlight that the method of a direct pay-setting dialogue between employer and employee has proved successful because it increases the employee's understanding of the connection between performance and pay. It also puts emphasis on leadership and makes the role of the employer more visible.

The authority to negotiate and conclude collective agreements on behalf of the central government has been delegated to the Swedish Agency for Government Employers (SAGE). The agreements establish levels of general pay increase⁵ and other employment conditions for central government and are binding on the public employers it represents. SAGE has, to an increasing extent, delegated the authority and responsibility to negotiate and decide on employment conditions to the agency level with the aim to better adapt the use of the agencies' resources to the requirements of each separate agency.

The Swedish Agency for Government Employers (SAGE)

SAGE is an arm's length agency, resorting under the Ministry of Health and Social Affairs, representing all government employers. SAGE's members are the government agencies. Membership is compulsory for all agencies. Its activities are financed from contributions paid by agencies (including the Government Office⁶). The supreme governing body of SAGE is the Employers' Council consisting of 250 agency heads, which meets annually. The Council decides on issues of strategic and financial importance. The Council elects the 15 members of the Board of the SAGE. The election is confirmed by a Governmental decision.

The Board is the executive body of SAGE between the meetings of the Council and decides on more technical matters with respect to negotiations. The Board appoints the Director-General of SAGE.

A factor that has changed the role of SAGE since the 1990s is a reform of the state budget procedure. Whereas under the former procedure the agencies were entitled to an extra appropriation if a collective agreement resulted in larger pay increases than had previously had been assumed, the agencies now have to accommodate all wage expenditures from their predetermined appropriation. The appropriation is based on an assumption about wage increases in the private sector decreased by a cut based on productivity increases in the private sector (see Reform 7.4 on automatic cuts of productivity dividends). This means that agencies receive their entire appropriation at the start of each fiscal year and then bear final responsibility for any cost changes, including increased expenditure on pay and other employee benefits.

The stages of negotiations in Sweden

The Basic Agreement and the Co-operation Agreement are established between SAGE and the unions for the central government sector and must be approved by government. These agreements regulate the process of negotiating pay levels and general conditions of employment and set out how the parties may act in the event of industrial action. The agreements also establish basic regulations to govern such action.

Within this agreed framework negotiations are first carried out at central level between SAGE and the three main unions. The parties conclude a central collective agreement, which sets out the framework and preconditions for local pay negotiations for the relevant period. Central agreements cover job security, pension systems, working hours, holidays and other general employment conditions broad enough to still allow parties at agency level to adapt the terms to their own conditions.

In the second stage negotiations takes place at agency level between the employer and the local unions. Pay levels for individual employees can also be decided in a pay-setting dialogue between employer and employee in which the employee can be assisted or represented by the local union. Furthermore, other employment conditions may be adapted to local conditions through collective agreements, e.g. working hours, health benefits, etc. Local collective agreements specifying forms of co-operation between the employer and the local unions in more detail may also be concluded. No industrial action may be taken while these negotiations are underway.

Benefits of the Swedish model

The benefits of the Swedish pay-setting model are the following:

- Negotiations at the central level promote a number of uniform standards across the general government (on increase of general pay levels, pensions, holidays, etc.) so that in these respects no unjustified differences can arise between agencies. Simultaneously, this model remains decentralised enough to accommodate the business needs of each agency. Agency heads retain the right to decide on pay of certain groups of employees or individual employees in light of job requirements, performance and market conditions.
- Co-operation of government employers in a single arm's length agency is efficient. Unnecessary transactions costs are avoided.
- The government employers agency is not only responsible for central pay bargaining but also for providing support and advice to all de-central pay setters. Pay setting and bargaining is a difficult profession, and it is essential that agency managers who are not experienced in this area can fall back on a professional centre of expertise to support them in this task.
- The two-level bargaining model with predetermined appropriations for operational expenditures implies that a firewall exists between pay-setting and budgeting. This firewall guarantees that the budgetary envelope does not become a subject of pay negotiations.

Feasibility of the reform

The Swedish model is applicable in all OECD countries where government wages are negotiated between government employers and (representatives of) employees. In many countries central bargaining is fragmented (divided in pay-sectors each with their own negotiations) and pay conditions are overly rigid, with limited opportunity of separate employers to adjust pay conditions to business needs. In these countries, the adoption of the Swedish model can lead to substantial savings and better adaptation of human resources to business needs.

Reform 8.4. Reduction of abolition of performance-related pay

Characteristics of the reform

This reform consists in reducing or abolishing performance related pay (bonuses) for government personnel.

Where did it occur?

An OECD study notes that “two-thirds of OECD member countries have implemented performance-related pay or are in the process of doing so. However, there are wide variations in the degree to which performance-related pay is actually applied throughout an entire civil service” (OECD, 2005). A subsequent OECD study (OECD, 2012a) found that the United Kingdom, Switzerland and the Czech Republic apply performance-related pay more extensively than other countries, while New Zealand, Austria and the Netherlands apply it the least. According to this study, six OECD countries (Belgium, Greece, Iceland, Mexico, Poland and Turkey) do not use performance-related pay at all.

Analysis

Definition

Performance related pay is a variable share of salary that complements the base pay. The base pay is usually linked to an employee’s position and is uniform across similar positions. It is often cited to compare wages in the public and private sectors⁷. The variable pay that comes on top of the base pay can include performance-related pay, but also other elements, such as remuneration linked to the nature or duties of a post. The latter relies on an *ex ante* evaluation of “anticipated” or “likely” performance based on job demands (for example, by assessing the qualities needed for the particular duties associated with the position) while performance-related pay relies on an *ex post* evaluation (OECD, 2005:11). Performance-related pay is awarded annually (or on any other periodic basis) depending on performance, while the decision on the variable pay linked to the nature or duties of the post is has taken at the start of employment. Performance-related pay can vary depending of staff positions to which it applies, on the targets they apply to: individuals or groups; the extent to which rankings are used; and on its size.

The concept of performance related pay comes from the private sector. Performance pay in the private sector can include financial participation (profit sharing and share ownership) next to fixed bonuses. Profit-sharing schemes make individual pay dependent on the companies’ performance and may be distributed in various ways (fixed rates or *ad hoc* distributions, with or without employee representatives’ involvement and negotiations).

What are the problems with performance related pay?

Arrangements of performance-related pay have been introduced in many countries during the 1990s. The OECD study of 2012 shows that performance-related pay has been used frequently in recent years: “there has been an on-going transition at all levels of government over the past 20 years to performance pay policies in many OECD countries” (OECD, 2012a). The earlier OECD study (OECD, 2005:11) observes that the countries

which have developed the highest delegation of responsibility for human resources and budget management to ministries and agencies are most likely to use the system of performance appraisals and pay as employee incentives (Australia, New Zealand, Sweden, UK). Performance pay fitted well into the business oriented approach in public administration that was advocated by the school of New Public Management which inspired many reforms in these years.

The experiences of countries where performance related pay has been introduced point at two major problems that have hampered the realisation of the intended results. First, in order to be effective, performance pay must be seen to be fair. This requires openness and transparency, so that everybody is informed about who gets a bonus of what size. It also requires that a bonus is only paid to a small group of outstanding performers. Indeed, the larger the group who receives a bonus, the more cases of doubt and the more room for arbitrary decisions. Furthermore it requires that outstanding performers at all levels of hierarchy receive a bonus and that bonus payments are not arbitrarily concentrated in the highest ranks. These conditions of fairness are rarely met. In practice, bonus payments are often made in a sphere of semi-secrecy, to large groups of officials, strongly concentrated in the highest ranks.

Box 8.1 provides an example of how the regulation on performance related pay in the German Federal Government prevents that performance related pay is awarded at a too large scale.

Box 8.1. Variable pay for civil servants in the federal government in Germany

The rules for performance pay in Germany are enshrined in the legislative acts “*Bundesbesoldungsgesetz*” and “*Bundesleistungsbesoldungsverordnung*”. Civil servants can be awarded performance bonuses (one-off payments) and performance allowances for outstanding special service. No more than 15% of civil servants can receive a bonus or allowance per calendar year. Performance bonuses can amount to a monthly basic salary corresponding to the grade of the civil servant. Performance allowances are paid continuously on a monthly basis, for a maximum of one year; they can be withdrawn if performance is not up to standards. Performance allowances can reach a maximum of 7% of the monthly basic salary.

Performance bonuses and allowances may be also awarded to teams and then they are considered as only one award of the overall quota. They may not exceed 250% of the basic salary (bonuses) or 250% of 7% of the basic salary (allowances) of the civil servant in the highest pay grade in the team.

Second, even if the conditions of fairness are met, performance related payments tend to have a larger negative incentive effect on the officials who do not receive them than the positive effect on those that do receive them. Officials who do not receive a bonus, tend to feel undervalued if not humiliated, particularly if bonus payments are used on a large scale. While the positive incentive may be felt by a small majority of officials, a large majority may feel a negative incentive. In addition, officials who do receive a bonus may feel uncomfortable with the idea that they are paid for good performance. There is a certain degrading aspect to monetary compensation for good performance in the context of the civil service. Many civil servants have chosen for public employment for the very reason that they want to serve the common good, not to increase their income by special efforts.

Interestingly, even in the private sector, where performance related pay is normal since profit making is the essence of every business firm, the rationale of performance related pay for large groups of employees is currently questioned. For instance, new European rules that came into force at the start of 2014 will prevent banks from paying thousands of key employees' bonuses that are bigger than their annual salaries. It is one of the reasons why the pay in the financial industry will drop in 2014 (The Economist, 2014:52).

Why countries have not abolished performance related pay yet?

In an OECD-SIGMA report, Francisco Cardona argues that despite the growing consensus on the problems, performance pay policies are not being withdrawn (except in New Zealand that has abolished performance related pay) or continue to be introduced in OECD member countries (OECD-SIGMA, 2007). The report suggests that the reason is not that performance-related pay is effective in itself, but rather that it has positive secondary effects. For instance, it facilitates organisational changes that result in effective appraisal and goal setting processes, clarification of tasks, acquisition of skills, creation of improved employee-manager dialogue, more team work and increased flexibility in work performance. The momentum gained in implementing performance-related pay could have positive outcomes for the organisation overall.

One of the effects alluded to in the OECD-SIGMA report is that managers like performance pay. They use it as an additional tool to manage their staff. But this points simultaneously at a risk. It may be expected from a civil servant that s/he “speaks truth to power”, that s/he freely expresses his/her views on facts and analytical results, even in cases when senior managers and politicians may not welcome the message. Performance related pay tends to undermine the culture of respect for the facts, objective analysis and impartiality that ought to prevail in the civil service. The changes outlined in the OECD-SIGMA report (e.g. improved employee-manager dialogue, more team work, etc.) can be developed in the public administration in a more straight forward manner.

Recently, the government of Luxembourg has introduced reforms that aim to provide better incentives for performance without performance related pay. Instead, a more systematic career development policy has been defined. Promotion decisions and decisions to grant next salary steps in grade/scale grids (leading to permanent pay increases) will partly be based on a systematic procedure of performance assessment (an assessment procedure previously did not exist in Luxembourg).

Setting public pay in the post-crisis period

Public sector pay has been affected since 2008 by governments' consolidation programmes and austerity measures aimed at reducing public expenditure. Almost all governments had to introduce wage cuts and freezes, reductions in public sector jobs and recruitment stops. These and other consolidation measures have led to cuts or, in some cases virtual abolition of performance related pay, in the countries that have used it in the past. However, these measures were based on temporary fiscal circumstances and not on reconsideration of the costs and benefits of the tool as such. The current reform entails the reduction or abolition of performance pay in the light of policy considerations, in particular in view of its costs and lacking evidence about its benefits.

Feasibility of the reform

The reform is feasible in all countries where performance related pay exists and will lead to budgetary savings on relatively short term.

Reform 8.5. Top civil servants appointments*Characteristics of the reform*

This reform consists in establishing a procedure for the appointment of top civil servants which exclude interference by politicians without impairing the responsiveness of civil servants to the government of the day. The underlying idea of the reform is to maintain strict neutrality of the civil service in order to ensure that politicians are informed about all relevant facts and all relevant results from policy analysis while deciding on policies and executive policies and that the laws and policies are executed with strict impartiality.

Where did it occur?

Countries have different recruitment processes for the Senior Civil Service (SCS) with different levels of openness of the recruitment procedure. This has partly to do with the fundamental dichotomy between career based and position based standards of human resource management (see introduction to this chapter). However, under both types of standards, a strict separation of civil service and political responsibilities can in principle be ensured.

The key challenge for all the SCS appointment procedures is to select the best managers while ensuring responsiveness to the government of the day. From the information collected for the present study it appears that of all countries participating in the study, the UK and the Netherlands have introduced the most solid and strictest guarantees for independence of the civil service.

*Analysis**Neutrality and responsiveness*

The selection of top management is a key factor for the quality of the civil service. The appointment process is a key mechanism to ensure that the most competent, experienced, motivated and performing candidates are selected to the top positions.

OECD countries have different procedures in place for the appointment of top civil servants. Some countries practice so-called “spoilage” procedures, which imply that a number of top civil servants are appointed by the government of the day. The positions to which spoilage procedures apply are usually designated and relatively stable. The officials concerned are supposed to resign when a new government takes office. The clearest example of a country where the spoilage practice prevails is the USA. But some European countries, including some included in this study, follow comparable procedures. An example is Sweden, where political criteria can be applied to the appointment of Directors-General of agencies, and where in each core ministries there are several political State Secretaries, who have similar responsibilities as top civil servants in other countries. A general overview of the practices in this regard among the countries included in this study is provided in Reform 11.2.

The main argument for spoilage procedures is responsiveness to the government of the day. This argument supposes that the government can only execute its policies in an effective way if top officials have the full confidence of ministers and can be handpicked by ministers to ensure such confidence. However, there are also arguments against such procedures, notably:

- Policy making and policy execution is not only a political, but also a technical task. Spoilage procedures weaken guarantees that relevant information about facts and policy analysis and policy evaluation reaches the politicians who take the ultimate decisions. It is doubtful whether more than a single politician at the head of each ministry is needed to bear political responsibility if the top civil servants fulfil their role in an appropriate way.
- Valuable experience is lost if top officials are supposed to resign with the government of the day.
- There is an risk that policy and executive policy (the policy of execution if the primary policy leaves any room for discretion) are affected by undue political pressure, that is to say pressure that neglects information, even if such information is available and reaches the decision-makers, or pressure that impairs an equal and impartial execution of the prevailing laws and policies.

In the countries included in the study, these arguments have generally led to certain guarantees that screen the appointment of top civil servants from the government of the day, but these guarantees are not always very strict and often recognise exceptions.

In many countries there is a debate among human resource specialists, that every now and then flares up to wider circles, about the right balance between guarantees for neutrality and guarantees for responsiveness to the government of the day. This is even true for countries such as the UK that have traditionally adhered to strict principles of neutrality⁸. In this light it is important to consider the conditions that can ensure responsiveness if prevailing procedures exclude or minimise a role of politicians in the appointment of top civil servants.

For that purpose it is important to recognise that the role of top civil servants is not limited to advising their political masters on the basis of information about facts and policy analysis and evaluation. Policies and executive policies can only be effective if there is enough consensus among stakeholders. Stakeholders include interest groups in society that are affected by the costs and benefits of policies and executive organisations.

Ministers are sensitive to the views of interest groups because endorsement by interest groups is an important factor in elections. Political economists have since long recognised the relevance of this factor for the electoral behaviour of so-called passionate minorities (who let their vote depend on issues that are particularly important for them). Since every minister has to deal with many interest groups, s/he cannot possibly deal with all of them by her/himself. If the top civil service is not politically appointed, this task falls to career civil servants. This requires special capacities in the sphere of political sensitivity and negotiation skills. These capacities must be explicitly recognised as criteria for appointment in order to ensure responsiveness to the government of the day.

Similarly, ministers are sensitive to the views of executive organisations. This includes service delivery agencies as well as private non-profit institutions tasked with policy execution. One can think of teachers, police officials, and health care providers such as doctors and nurses. In every government this concerns hundreds of thousands of

employees who in their professional capacity are directly affected by public policies. Without enough consensus among executive organisations, policies cannot effectively be implemented. Fostering co-operation among executive organisations is therefore also a task that falls to career civil servants if the top civil service is not politically appointed. This requires special capacities too in the sphere of political sensitivity and negotiation skills.

Against this background it is important that political sensitivity and negotiation skills are explicitly recognised as appointment criteria for the top civil service, next to capacities in the sphere of policy analysis and evaluation and insight in the relevance of factual information. This must be seen as a condition for implementation of a human resource policy that eliminates or minimises the role of politicians in the appointment of top civil servants, while ensuring a sufficient degree of responsiveness to the government of the day. It should be noted that these skills have nothing to do with the political orientation of the civil servants concerned. These capacities can be found in any official regardless of political orientation.

Definition of Senior Civil Service (SCS)

There is no standard definition of SCS. Central governments retain distinct human resource classifications and the organisation of the civil service varies from country to country. However some common features of SCS were identified in different studies. An EU study defines the SCS as follows: “The senior civil service in a country consists of the top management positions of the permanent civil service, formally or informally recognised as a separate group of civil servants” (Kuperus, Rode, 2008). A World Bank study defines the SCS as the top management category of the civil service (excluding political appointees) when this is managed under a separate HRM policy that differs from that applied elsewhere in the public service (Lafuente et al., 2012).

Dutch and British systems

Senior Civil Servants (SCS) have special status in many OECD countries, but only a few have created a central SCS office. There are two countries included in this study that have created a specialised office for SCS management: the Netherlands within the Ministry of Interior and Kingdom relations and the United Kingdom within the Cabinet Office. A special central agency in Australia regulates the SCS, whilst ministries and agencies appoint their staff in accordance with the regulations. The practices of the Netherlands and the UK with regard to the appointment of senior managers and to the role played by the central offices in this process are described in the boxes below.

Box 8.2. The Netherlands

The Dutch Senior Civil Service (SCS) comprises 550 managerial posts in the Dutch Central Government (the Secretaries-General, the Directors-General, their deputies and the Directors) of which the Top Management Group accounts for about 65 posts (Secretaries-General and Directors-General). The recruitment procedure is position-based. The top civil servants are appointed for 7 years. When their term is completed they move to another SCS post, become a member of interim management group or continue their career outside the Central government.

The SCS Office (“Bureau Algemene Bestuursdienst”)

The key role in appointment of senior civil servants is played by a special unit of the Ministry of Interior and Kingdom relations – the SCS Office (Bureau Algemene Bestuursdienst). The mission of the SCS Office is to enhance the central government organisation through management development. For this purpose, the Office looks at management skills and experience and also at the diversity of their previous experience. In this regard the Office has decided that from 2011 onwards, executive experience will be required for promotion to the two highest levels of the civil service. It implies more emphasis on variety of experience in research and policy execution as the regular path of career development for all civil servants.

The SCS Office is also responsible for personal development of senior civil servants, peer consultations, career counselling, interim management, mediation for EU appointments, organising trainings and candidate programmes, facilitating out-flow employment by coaching senior managers for career opportunities outside the central government.

The appointment procedure

The SCS Office supports the appointment procedure for senior posts at the ministries and agencies by maintaining a pool of potential candidates. It bears responsibility for the quality of the candidates proposed for vacant posts and offers advice. The recruitment procedure goes through the following stages:

- When a SCS position is vacant, the SCS Office prepares a job description and announces a job offer on its web-site. Interested candidates have two weeks to apply for the position. All vacant positions are announced at least internally and under certain conditions externally.
- The SCS draws up a long list of candidates from the applications received for the job offer and from candidates in the pool that have been identified as suitable, the latter after being consulted by the SCS on interest. The long list is discussed with the official responsible for the vacancy (for example, for the position of the deputy Director General the list is discussed with the relevant Director General). For the top management group (65 posts) the long list is presented for comments to the Prime Minister, his deputy, the Minister of the Interior and the Secretary-General of the Office of the Prime Minister.
- The SCS Office reviews the long list, meets with candidates and draws up a short list of candidates (usually up to 10 people).
- For the top management group a pre-selection committee comprising representatives of the Prime Minister Office, of the SCS Office, the Secretary General of the ministry concerned and chaired by an independent expert (at present it is an HRM expert of ING bank) selects 2-3 candidates for the final selection round.

Box 8.2. The Netherlands (continued)

- For the top management group, a selection committee comprising the Secretary General of the ministry concerned, the Director General of the SCS Office or his deputy and a top manager from another line ministry meet with the candidates.
- The candidate selected for a post in the top management group meets with the Minister of the ministry concerned and with the Minister for Interior and Kingdom relations. The Minister of the line ministry has the right to veto, but in practice it is rarely exercised.
- For the vacancies below the top management group, the Minister for Interior and Kingdom relations approves the appointment; however the ultimate responsibility for appointments rests with ministries.
- The selected candidate is required to take part in a development assessment (evaluation of competences to be further developed) and a security check by the security office.

Source: Responses to Value for Money questionnaire and update from the Ministry of the Interior and Kingdom Affairs.

Talent Management Programme in the Netherlands

To better ensure individual development within the civil service and provide the talent pipeline to the top managerial positions, the SCS Office has established a Talent Management Programme. The programme is designed as a training course for civil servants who demonstrate capacity and interest to become senior managers. It intends to retain the most talented employees. The programme covers three core courses: “Know yourself”, “Know your business” and “Know your world”. Participants of the programme (20-25 people each year) take courses one day per week for which they can use a half day of their working hours and a half day of their free time.

The participants of the programme are selected in two rounds. At the first stage the management boards of line ministries propose their lists of candidates for the programme (up to five candidates). This list is then assessed on the basis of criteria developed by the SCS Office, including age threshold (candidates should not be older than 40 years old), leadership quality, experience in different types of ministries and positions (policy making and policy execution). The assessment is performed by an independent consultancy firm commissioned for this purpose by the SCS Office. At the second stage of the process, ministerial management boards consider the results of the assessment and select the two most suitable candidates for the programme.

Box 8.3. The United Kingdom

The Senior Civil Service makes up less than 1% of the whole Civil Service in the UK and comprises 2 753 Deputy directors, 685 Directors, 142 Directors General and 38 Permanent Secretaries. The two last categories constitute the 200 Top Management Posts.

Appointment of the 200 Top Civil Service Servants

The UK procedure for the appointment of top civil servants is merit-based but with some degree of political involvement for the top management level. The procedure is governed by the Recruitment Principles, made under the Constitutional Reform and Governance Act (2010), which sets out the legal interpretation of the principle of selection on merit after fair and open competition.

The Senior Leadership Committee and the Civil Service Commission play a key role in the process. The Senior Leadership Committee is a sub group of the Civil Service Board, a group responsible for the strategic leadership of the Civil Service. The Committee ensures that the Civil Service has the right leadership capability to deliver current and future priorities of Government by the effective management of talent, and improvement of leadership in the Senior Civil Service. The Civil Service Commission regulates recruitment to the Civil Service, providing assurance that appointments are on merit after fair and open competition. It consists of the Civil Service commissioners and staff. The Commission is an executive Non-Departmental Public Body sponsored by the Cabinet Office and independent of Government and the Civil Service.

A special protocol drawn up by the Senior Leadership Committee and the Civil Service Commission specify the way appointments to Director General, Permanent Secretary and equivalent positions should be handled. The protocol stipulates that the selection route for any appointment of the top management level (including assignments created as a result of departmental restructuring) are decided by the Senior Leadership Committee, on which the First Civil Service Commissioner sits. The Committee decides the route: external competition; internal competition; or a managed move of an individual at the same rank level, in light of a business case (provided by the Permanent Secretary of the Ministry with advice from the Senior Leadership Committee secretariat) weighing up the relevant factors as set in the Protocol.

Appointments are usually made via a competition and selection process comprising a panel chaired by the First Civil Service Commissioner for Permanent Secretary roles and a Commissioner for Director General positions. The panel usually comprises of the recruiting Permanent Secretary, another Permanent Secretary who is a member of the Senior Leadership Committee, a non-executive board member and/or an external stakeholder as members. Panels should be provided with uniform data and suitability evidence for all internal candidates and they should make every effort to ensure that comparable evidence is provided for all external candidates. Candidates are assessed against a common set of leadership criteria applicable to all Director General and Permanent Secretary positions, in addition to criteria specific for the vacancy. The panel makes a recommendation for appointment that is then agreed by the Secretary of State (Cabinet Minister in charge a government department) and approved by the Prime Minister. Permanent Secretaries may veto the candidate selected by the panel, however they are not able to choose between candidates. The explanatory note published in December 2012 by the Civil Service Commission explains how Ministers are involved in recruiting permanent secretaries. The Note specifies that the First Commissioner should fully ensure the involvement of the Secretary of State in the recruitment process: s/he should meet the Secretary of State at each key stage, and will be available at any point in time if the Secretary of State has concerns about the selection process or candidates.

Sources: Responses to the Value for Money questionnaire and update from the UK Cabinet Office.

Feasibility of the reform

Establishing procedures for the appointment of top civil servants which exclude interference by politicians without impairing the responsiveness of civil servants to the government of the day is possible in all countries included in the study. In order to ensure strict neutrality of the civil service it would be important to reformulate the recruitment criteria emphasising political sensitivity and negotiation skills.

Notes

1. Human resource support services are often also tasked with support in the area of (re) organisation. The current chapter does not address this task.
2. Ministry of the Presidency of the EU (2010). Australia, Canada, Norway and New Zealand were categorised by the OECD Secretariat on the basis of country information.
3. A merger process of the “*corps d’État*” is already under way (previous mergers have reduced the number from 700 in 2008 to 380 in 2012. Further mergers are currently envisaged (to 230 by 2015).
4. See more at www.basware.com/sites/default/files/upload/basware-customer-success-2011-danish_state.pdf
5. This only concerns overall pay structures and salary increases, rather than salaries for individuals. Individual salary agreements are determined at the local level.
6. Since 2007 the Government Office (which includes all ministries) has the status of an agency.
7. Definition extracted from <http://www1.worldbank.org/publicsector/civilservice/glossary.htm>
8. The procedure of top civil servants appointment is at the heart of recent political debates in the UK. See for instance: “*Ministers renew battle to control top Civil Service jobs*”, (The Times, 2013); and “*Prime Minister should appoint top civil servants, report recommends*” (The Guardian, 2013).

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Chapter 9

ICT management

This chapter focuses on recent developments in the area of ICT management. Attention is given to the organisation of ICT support services and to the tasks of ICT standard setters. Developments are moving fast in both areas as a consequence of e-government policies. Moreover, there is in all participating countries an increasing emphasis on net savings as an objective of ICT investments.

The reforms presented in this chapter focus on savings and preventing losses. For that purpose standards of ICT management have to be upgraded, including open and mobile standards, and the organisation of standard setting has to be streamlined. Furthermore, there are large opportunities for co-operation between sectoral divisions of ministries and agencies concerning ICT systems that are part of their primary process. These include the basic registers of population, land, legal persons and motor vehicles, but also systems that are used by a limited number of ministries and agencies, such as the tax administration, the police registers, the client registers of the social security agencies, the student registers and the registers of subsidy clients in various areas of government policy. Another area of co-operation that grows rapidly in importance is that of cloud computing. The use of public clouds can lead to substantial savings on software, hardware and services.

In many participating countries, there is an increasing concern about failing ICT projects. In order to minimise the probability of failure, several countries have established gateway procedures. The chapter presents one reform concerning recent, well designed and evidence based gateway procedures.

Introduction

ICT and Value for Money

Technology can make a difference in improving services and cutting costs, but it can do more than that. Technology enables the government not just to cut costs but to adopt fundamentally different ways of task performance. Government operations can be run differently, citizens can interact with government in new ways that focus on the needs of the individual.

Currently, many OECD countries are in the process of reviewing their ICT management procedures to ensure that IT solutions help generate savings, but also generate value for money¹. This means that today's governments are trying to find the right balance in ICT management between a pure cost savings perspective on ICT projects and the need to invest in the government of the future and to achieve the transformation ICT can also potentially bring.

The context of e-government policy

All OECD countries currently have plans and strategies in place for digitising government services, including the countries included in the study. These plans and strategies are profoundly changing the nature of public services provision and will continue to do so in the near future. Although, as argued in Chapter 1, this transformation is not seen in this study as the predominant feature of the next stage in the development of public administration, it is without a doubt an important feature, and it will, more than any other development concerning support services, have a profound effect on the practices of public administration. The transformation towards digital government entails particular challenges to ICT management. For a proper understanding of the reforms presented in this chapter, it is useful to pay attention to the context of e-government policy.

Although the countries included in the study are in different stages as far as the development of e-government is concerned, it is possible on the basis of current plans and strategies to identify a number of aims that countries seek to achieve. While the aims may differ from country to country, common components typically include:

1. The government sector should be accessible online to the extent possible. Digital information exchange should be the general rule for communication with the government.
2. Web-based services are to be the general rule for all services that consist of processing of cash payments (payments of taxes and fees by citizens and businesses to the government, and payments of subsidies, grants and social benefits by government to citizens and businesses), processing of legal decrees in individual cases (permits, licenses, concessions, admissions) and processing of access procedures for service delivery in kind (health services, education services, social services in kind, etc.).
3. Digital services should lead to an improvement of service delivery for citizens and businesses in the sense of cheaper, faster and simpler administrative procedures.
4. The government should focus service delivery on the needs of individual citizens and business. The importance of developing citizen and business centred services

is clear: the more user-centred and personalised government services are, the more their take-up is likely to increase and the more benefit can be realised.

5. Digitalisation of the government sector should free up resources for areas in need of more resources or for tax relief or deficit reduction.

An important new approach in e-government policy is known as “lean government”². This approach refers to the application of lean production principles and methods to both identify and then implement the most efficient way to provide government services. Government agencies have found that when lean methods are implemented, they see an improved understanding of how their own processes work, that it facilitates the quick identification and implementation of improvements and that it builds a culture of continuous improvement. Lean government proponents generally believe that the government should cut out “waste” and “inefficiency” from government organisations; this in turn will result in better services overall.

Other relevant initiatives focus on collection of information about public sector innovation. There have been various notable projects in Europe such as the “Measuring Public Innovation in the Nordic countries” (MEPIN) project or the UK government’s creation of a national Public Sector Innovation Index. The European Commission publishes an annual “European Public Sector Innovation Scoreboard” as a first EU wide attempt to better understand and analyse innovation in public sector (EC, 2013a). The OECD is developing an Observatory of Public Sector Innovation. The Observatory aims to systematically collect, categorise, analyse and share innovative practices from across the public sector, via an online interactive database (OECD, 2013a).

The tasks of ICT support service units

ICT support includes: advice concerning ICT solutions, development of ICT solutions and support in the procurement of ICT equipment and services (hardware, software, expertise).

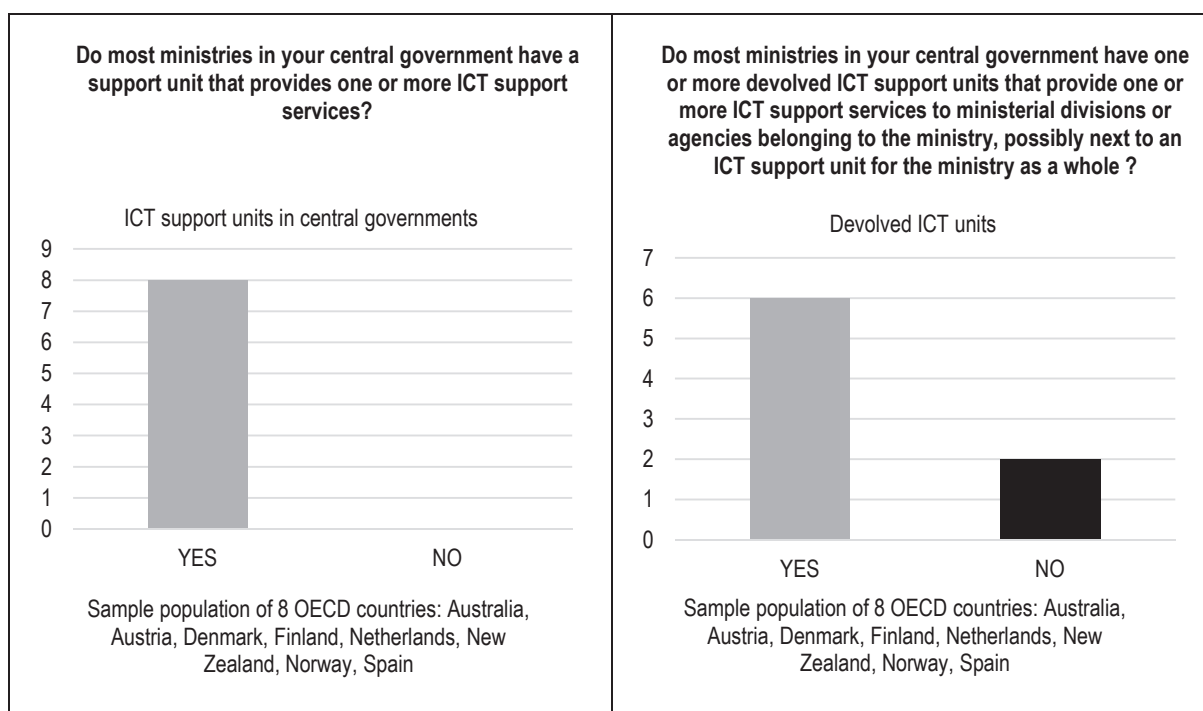
ICT support may also include the management and maintenance of ICT systems that can be considered as belonging to the primary process of the ICT units themselves as well as services connected to these systems. At the de-central level this typically includes: office automatisations, intranet, help-desks, website development and maintenance. At the central level this typically include: management of government portals and platforms for information exchange (including electronic IDs), digital citizen mailbox and government-wide intranet and information services.

According to the OECD Value for Money questionnaire all the countries that answered had ministerial ICT support units (Figure 9.1). These covered slightly different tasks, of which all included:

- Maintenance of an intranet or part of a wider internet;
- Providing desk top facilities;
- Providing a help desk for desk top facilities;
- Design and maintenance of common portals;

Most countries that answered had ministerial ICT support services but also had devolved ICT support service units in ministerial divisions and agencies.

Figure 9.1. ICT support services units



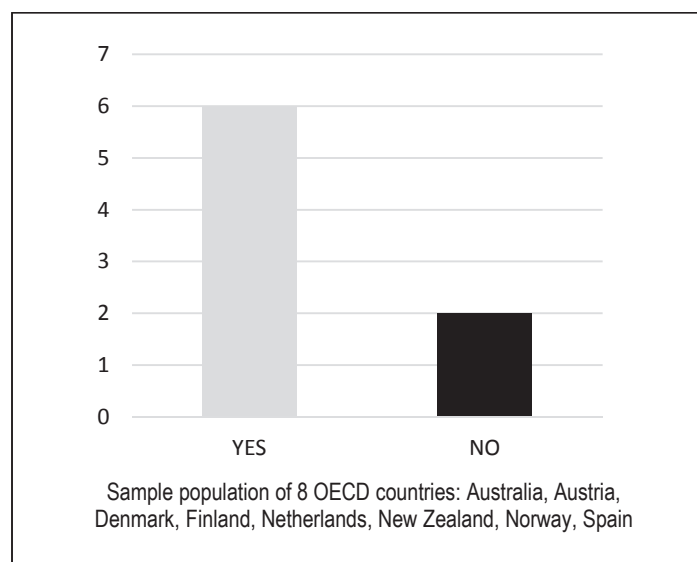
Source: Responses to the Value for Money questionnaire.

The separation of responsibility between units tasked with ICT support service delivery and line units can differ in the countries included in the Value for Money study. ICT support service units are sometimes responsible for the management and maintenance of ICT systems that are seen in other countries as belonging to the primary task of line units. However, in each country, there are ICT support units at the government level, as well as at the ministerial and sometimes division or agency level that have a different role and responsibility than the line units that make use of their services. Both types of units report in different lines of hierarchy and can thus clearly be distinguished in each country, although the task distribution may differ between countries.

As mentioned in Chapter 6, central support services are often organised as divisions or agencies of a central ministry (often Ministry of Finance or Ministry of the Interior or Public Administration). They provide services to the government as a whole. Examples are: the government's buildings office for accommodation, the government's purchase office for procurement, and the government's information office for communication. This also applies to central ICT support services.

Central support services can be distinguished from shared service centres. These centres are a relatively new phenomenon and have arisen in the last decade in order to rationalise de-central support services by concentration, allowing specialisation, economics of scale and a more attractive working environment for specialists. They are often organised as agencies of a central ministry as well, but they are generally tasked with de-central support service delivery. This distinction can also be observed in relation to ICT support services. Answers to the OECD Value for Money questionnaire reveal an increasing trend towards shared service centres for ICT support services (Figure 9.2)

Figure 9.2. Is there one or more shared support service centres in your central government that provide ICT support services to ministries?



Source: Responses to the Value for Money questionnaire.

However, in the fast moving area of ICT, the distinction between de-central and central support services is losing relevance. Therefore the focus in this chapter will be on support services provided at the central governmental level, regardless of whether they should be seen as genuine support services for the government as a whole or as shared services of ministries and agencies. The task of these units can be described as the development and maintenance of the central ICT infrastructure for the government as a whole.

This includes:

- a. advise to the government and to ministers and agency heads concerning ICT solutions, development of ICT solutions and support in the procurement of ICT equipment and services (hardware, software, expertise).
- b. ICT primary processes, including:
 - the development and maintenance of the central government portal and the technical platform for submission of digital forms to the government; the platform should also be able to provide for transmission of digital messages to and from the government and to provide access to publicly available data as well as to individual privacy sensitive data;
 - the development and maintenance of government-wide intranet and information services;
 - the development and maintenance of the digital mailbox for citizens and businesses;
 - shared services in the area of office automatization, intranet, help-desks and website development.

The task of ICT standard setters

In order to achieve the aims of e-government, standards in the area of ICT must ensure that:

- the government provides unified and user friendly digital services;
- digital service provision is obligatory for businesses and specific citizens groups such as students; for other citizens it is the default option next to paper procedures, telephonic procedures and face to face procedures that must remain available for citizens unable to handle digital procedures;
- the government provides assistance to businesses and citizens in handling digital service provision through help desks as well as telephonic and face to face assistance;
- all citizens and businesses will receive mail from government in a secure digital mailbox and be notified about messages via post, SMS text messages and e-mail;
- protection of privacy and information security is safeguarded; this requires among other things electronic ID procedures;
- digitization measures of relevance for several services is co-ordinated; it must be ensured that citizens and business are to provide information only once;
- citizens and business have access to all databases held by the government that do not contain privacy sensitive data, including central registers (“open government”); and
- citizens and business have safe access to all data that the government holds about them and are able to correct these data.

Devolved standard setters in ministries are responsible for the implementation and specification of central standards within ministries and the agencies under their umbrella and may set additional ministry specific standards.

Savings through ICT

In their endeavours to digitise public service provision, OECD governments are trying to find the right balance between a pure cost savings perspective on ICT projects and the need to invest in government of the future and to achieve the transformation of service delivery that ICT makes possible.

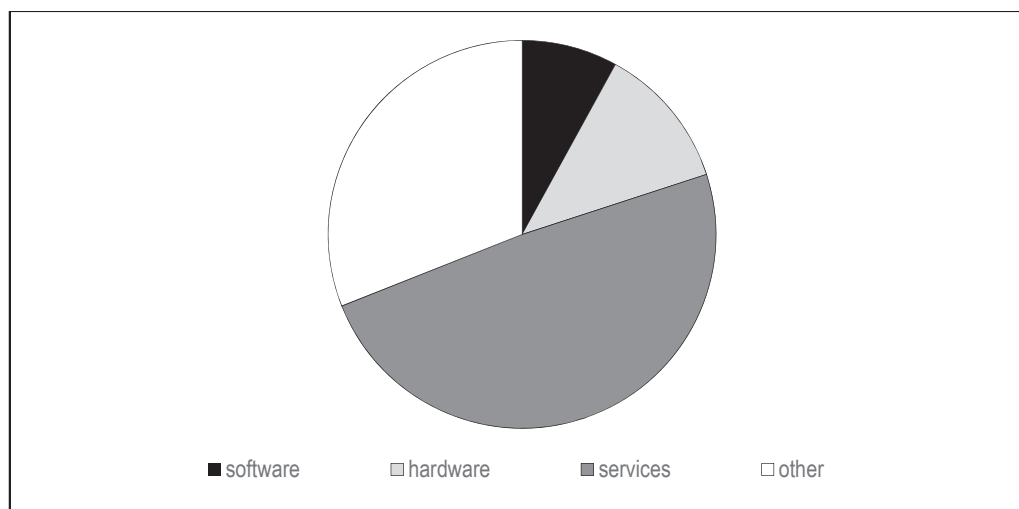
In order to record savings, it is necessary to first define ICT expenditures. This is not an easy task, as ICT expenditure cannot simply be equalled with the expenditures of ICT support units. Since ICT is a tool that is used in the primary process of line units of ministries and agencies in the first place, its costs must be composed of ICT costs in line divisions as well of the costs of support units.

The recent “UK Public Sector ICT Overview and Forecast to 2014/15” report³, published by Kable in November 2009, lays out the following break-down of ICT spending in the UK as an example.

In 2009, the UK public sector spent a total of GBP 17.9 billion on ICT (Figure 9.3). Of this, 8% (GBP 1.4 billion) was spent on software. A further 12% (GBP 2.2 billion) of the total spent was on hardware whilst the largest single category was for services which

consumed 49% (GBP 8.7 billion). Of services, the largest sub-category is IT outsourcing at GBP 4.9 billion (56% of the total Services cost). The costs of ICT support services of the government and of ministries and agencies were equally recorded as services.

Figure 9.3. ICT spending in the UK



Source: UK Cabinet Office (2012a).

The UK governments report “One Year On: Implementing the Government ICT Strategy” (UK Cabinet Office, 2012a) mentions the following savings at central government level from May 2010 to March 2011 prior to the publication of the ICT strategy:

- GBP 300 million by applying greater scrutiny to ICT expenditure and departments stopping or reducing spending on ICT projects which show a low return on investment;
- GBP 570 million from renegotiating deals with some of the largest suppliers to government;
- GBP 140 million by centralising procurement.

In 2012 the UK’s Cabinet Office reported the following savings:

- GBP 159.6 million by demanding a rigorous business case for any significant ICT spend;
- GBP 140 million of the GBP 490m saved by centralising procurement of common goods and services;
- GBP 64.2 million from telecommunications networks budgets by applying better, common standards.

In response to the OECD’s questionnaire, the Australian government noted that the Australian Government initiated an independent review of the Australian Government’s use and management of ICT in 2008. The review provided a comprehensive and detailed analysis of a wide range of issues affecting the Government’s use and management of

ICT and also outlined a staged plan for the implementation of recommendations. In November 2008, the Government endorsed recommendations of the Review in full and initiated the ICT Reform Programme. Phase one of the programme was completed with savings of approximately AUD 570 million being identified. The completion of the second phase of this programme has now been completed with savings of close to AUD 430 million identified between 2010-11 and 2012-13.

In the Netherlands an attempt is under way to estimate the costs of ICT according to the scheme of Table 9.1. The scheme makes a distinction between the costs of ICT support units (“administrative costs” or “apparatus costs”) and ICT costs as part of the primary process of line ministries and agencies (“programme costs”).

Table 9.1. Costs of ICT

	Hardware	Software	Outsourced services	Inourced services
Programme costs				
Administrative costs				

Sources: Responses to the Value for Money Questionnaire and update from the Ministry of the Interior and Kingdom Affairs.

ICT reforms can give rise to savings in three different ways:

1. Central standard setters may impose reforms of the central ICT infrastructure. This leads in general to additional costs of ICT support units (administrative costs) and savings on the costs of the primary process of line ministries and agencies (programme costs, including ICT programme costs);
2. Central standard setters may impose reforms to increase efficiency or adjust the service level of ICT support services. This leads in general to lower costs of ICT support units (administrative costs);
3. Line ministries or agencies may adopt reforms of ICT applications in their primary process. This leads in general to savings on the costs of the primary process of line ministries and agencies (programme costs, including ICT programme costs).

Examples of reforms of the first kind concern the shift towards “Digital by default” as were implemented in the UK and Denmark (see Box 9.1 and Box 9.2).

Box 9.1. Digital by default in the UK

In June 2012 the UK government published its Civil Service Reform Plan that stressed the need for change in response to the economic downturn coupled with rising consumer expectations. The Plan stated: “The public increasingly expects to be able to access services quickly and conveniently, at times and in ways that suit them, and the Civil Service needs to meet these expectations rather than expecting citizens to meet the Civil Service’s processes. It needs to become Digital by Default, in its skills, its style, how it communicates and how it enables service users to interact with it”. Digital by Default means that digital services should be so straightforward and convenient that all those who can use them will choose to do so, whilst those who cannot access digital services should not be excluded.

Following on from the Civil Service Reform Plan the Government published its Government Digital Strategy in November 2012. This strategy document sets out how government will redesign its digital services to make them so straightforward and convenient that all those who can use them prefer to do so.

The strategy:

- follows the March 2012 Budget commitment to digital services being the default;
- has been developed collaboratively across government, as part of the Civil Service Reform Plan;
- has been followed up with departmental digital strategies, published in December 2012;
- is supported by a cross-government approach to assisted digital provision.

The strategy also describes how delivering services digitally will result in savings of GBP 1.7 to GBP 1.8 billion each year, and commits government to a series of actions that are mainly about transactional services such as applications, tax, licensing and payments. The strategy explains how the civil service will develop new skills and approaches to complement its existing expertise. It also includes actions to improve the way the government makes policy and communicates with people.

Sources: UK Cabinet Office (2012a, 2012b); UK Government (2012b).

Box 9.2. Digital by default in Denmark

Denmark has a long tradition of digitization and has been ranked as world-leading and trendsetting in many independent international surveys. Since the mid-1990s, Denmark has developed ICT in government and in society through ambitious information society plans. Since 2001, Denmark has focused on how to reap the full benefits of using ICT in the public sector. Digitisation of the public sector has therefore been a key contributor to public sector modernisation for more than 15 years.

Building on a digitally mature population, the Danish government approved a new e-government strategy and action plan for the period 2011-2015. Across the whole of the public sector digitisation is aiming at: permanent cost-savings of €403 million, 80% digital communication in the public sector by 2015, and demonstration and documentation of work-saving potentials along with making the public service delivery easy to use, efficient and effective through digitization.

A key component of the strategy is to move users online, including using an important policy lever of regular so-called “e-days” as deadlines and targets by which specific milestones become mandatory, not only for the public agencies but also for citizens and companies.

Box 9.2. Digital by default in Denmark (*continued*)

Denmark has an excellent starting point for reaping the full benefits of ICT use in the public sector. As the Danish population generally is ready for e-government services (among the highest uptake of computers and the Internet in Europe), Denmark has taken the next logical step towards making mandatory the use of online public services. A government strategy and action plan covering the period 2011-2015 will – when fully implemented – make “digital by default” a reality for citizens and businesses and public service delivery more cost-efficient.

Source: Danish Government (2011).

Reforms of this chapter

The current chapter presents three reforms in the area of ICT management that fit in the current trends to digitise public service delivery while ensuring both savings (for the government) and improved service quality through faster, cheaper (for citizens and businesses) and simpler administrative procedures.

These reforms focus on:

1. Improvement of ICT standards;
2. Common ICT process units;
3. Stricter gateway procedures for new ICT projects.

This chapter focuses on ICT management in central governments and has not been intended to deliver an extensive review of ICT adoption in government, e-government or of innovative government solutions (such as the potential of social media for government, and collaborative government solutions). These issues are examined by OECD reports⁴.

Reform 9.1. Improvement of ICT standards

Characteristics of the reform

This reform consists of the setting of government wide standards that aim to ensure safe communication and transmission of data between governments and citizens/businesses and between units of government, as well as interoperability within government and public accessibility of data and data sources, including from mobile devices. The reform does not cover all standards as mentioned in the introduction but it covers a large domain⁵.

Where did it occur?

Countries that are at the forefront of innovation in the area of ICT standard setting include the UK and Denmark.

Analysis

Key areas of standard setting.

Standard setting is defined in this study as issuance of general rules with respect to operational management. Managers responsible for operational management have to

respect these rules. These standards are generally set for the whole of central government by authorities who are located in central ministries (Finance, Interior of Public Administration, and Prime Minister). Furthermore, central standards are often complemented by de-central standards which are set by the permanent secretaries (highest civil servant) of the ministries.

In order to facilitate the wider diffusion of electronic administration, it is important for citizens to have confidence that electronic procedures are performed as securely, efficiently and under the same legal safeguards as traditional paper-based procedures. This calls for strict government wide standards.

Standards lay the foundation for a sound e-governance architecture, which should be open and technology neutral, thus ensuring vendor independence. Standards based applications can be customized easily, enabling faster deployment. Standards facilitate interoperability and process sharing between units of government.

Key areas that need to be addressed in the reform of ICT standards include:

- Standards for authentication and trust services;
- Interoperability standards;
- Open standards;
- Mobile standards.

a. Standards for authentication and trust services

One of the areas where most savings can be achieved is the area of transactional public services. Electronic transactions require authentication and trust services. Furthermore, authentication and trust services are the backbone of all online activities. For instance, electronic authentication provides assurance as to whether someone or something is who or what it claims to be in a digital environment. Thus, electronic authentication plays a key role in the establishment of trust relationships for electronic commerce, electronic government and many other social interactions. It is also an essential component of any strategy to protect information systems and networks, financial data, personal information and other assets against unauthorised access or identity theft. Electronic authentication is therefore essential for establishing accountability online.

Authentication and trust services are provided by electronic identification (eID) and electronic trust services (eTS) and include electronic signatures, electronic seals, time stamp, and website authentication. These procedures are inseparable and are needed to ensure legal certainty, trust and security in electronic transactions. The OECD has carried out several initiatives to support Member countries' efforts. The importance of authentication for electronic government and global electronic commerce was recognised in 1998 by OECD Ministers at the Ministerial Conference "A Borderless World: Realising the Potential of Global Electronic Commerce" held in Ottawa, Canada (OECD, 1998a). In their "Declaration on Authentication for Electronic Commerce" (OECD, 1998b), Ministers outlined a number of actions to promote the development and use of electronic authentication technologies and mechanisms (OECD, 2007b).

The EU has also taken the initiative to define EU standards for these procedures (Box 9.3) to work on cross-border solutions.

Box 9.3. e-ID and trust services in Europe – towards a common framework

The European Commission has recently adopted a new regulation on electronic identification and trust services for electronic transactions in the internal market (June 2012). It is aimed at ensuring cross-border legal recognition of electronic IDs, electronic signatures and other electronic authentication services in Europe as foreseen in the Digital Agenda for Europe. The measures will enhance trust in pan-European electronic transactions and enable electronic identification, authentication, signatures and related trust services, as well as a high level of data protection and user empowerment in the Single Market.

An Action Plan on e-Signatures and e-Identification has been adopted in 2008, with the aim to remove interoperability barriers.

Sources: EC (2013b); EU (2013).

b. Interoperability standards

Digital devices, applications and services should interact seamlessly anywhere, anytime. However, this is far from being the case across OECD countries. Fragmentation of technologies and services can hamper efficiency within the public sector and growth within the relevant ICT sector. Interoperability issues have been a growing development area in order to facilitate the seamless exchange of information. In the public sector these efforts are focused on the designing/adopting of Government Interoperability Frameworks (GIFs) and of Enterprise Architectures (EAs) for implementing interoperability, and increasingly issues such as better use of common databases.

The UK and Australia (Australian Government, 2013) have formulated an e-Government Interoperability Framework that lies at the heart of its strategy for ensuring that IT supports the business transformation of government to deliver better, more efficient public services (for the UK see box 9.4).

Box 9.4. UK's e-government Interoperability Framework

The UK's e-government Interoperability Framework (e-GIF) is based on the assumption that interoperable systems working in a seamless and coherent way across the public sector hold the key to providing better services, tailored to the needs of the citizen and business and at a lower cost. The e-GIF is one of the most mature of the national interoperability frameworks.

E-GIF is focused on specifications that are relevant to systems' interconnectivity. It sets out the government's technical policies and specifications for achieving interoperability and coherence of ICT systems across the public sector and defines the essential prerequisites for "joined-up" and web-enabled government.

The e-GIF's stated underlying principles are:

- Interoperability (only specifications that are relevant to systems interconnectivity, data integration, e-services access and content management are specified).
- Market support (the specifications selected are widely supported by the market, and are likely to reduce the cost and risk of government information systems).
- Scalability (capacity to be scaled to satisfy changed demands made on the system, such as changes in data volumes, number of transactions or number of users).
- Openness/transparency (the specifications are documented and available to the public at large).
- International standards.

Box 9.4. UK's e-government Interoperability Framework (*continued*)

The e-GIF's primary goals are to reduce the cost and risk for government systems while "aligning them to the global internet revolution" by facilitating the creation of interoperable systems that can work together coherently across the public sector in order to provide better and cheaper services, tailored to the needs of the citizen.

The e-GIF defines interoperability as the coherent exchange of information and services between systems, coupled with the ability to replace any component or product used in an interface with another of a similar specification while maintaining the functionality of the overall system. To be e-GIF compliant, a system should satisfy both of these requirements. Compliance is considered mandatory for all new systems that fall within the e-GIF scope. Public sector organisations, including government departments, their agencies, Non-Departmental Public Bodies, the National Health Service, devolved administrations (Scotland, Northern Island, and Wales), and local authorities are all bound by the recommendations and mandates of the e-GIF.

Source: Rothenberg, Botterman, van Oranje Nassau (2008).

c. Open standards

Many OECD governments aim to create open governments with the explicit policy aim to transform government services to make them more efficient and effective for users. The promise is that open standards will make public services simpler, clearer and faster for users and make government services more efficient. The main benefits of using open standards are: more choice of products and suppliers, less dependency on a single supplier, avoiding proprietary lock-in, stability or reduction in costs and the possibility to accommodate future changes more easily (Borras, 2004).

From a technology perspective, open standards encompass two key areas:

- **Open Data** – Leading Open Government advocate David Eaves (Eaves, 2009) defines Open Data as "the sharing of information government collects and generates freely towards citizens such that they can analyse it, re-purpose and use it themselves." Nigel Shadbolt, a member of the UK government's Public Sector Transparency Board (Shadbolt, 2010), uses a similar definition for his concept of "public data": "public data is the objective, factual, non-personal data on which public services run and are assessed, and on which policy decisions are based, or which is collected or generated in the course of public service delivery."
- **Open Source** –The Open Source Initiative (Open Source Initiative, 2013) defines Open Source as "a development method for software that harnesses the power of distributed peer review and transparency of process." OSI has published a ten point definition of open-source software which covers issues of licensing, redistribution rights and derived works as well as source-code.

An example is the Open Government Initiative in the USA. It addresses many ICT areas such as open data standards (see Box 9.5).

Box 9.5. The Open Government Initiative in the USA

The Open Government Initiative is an effort by the administration of President Barack Obama to "creating an unprecedented level of openness in Government". On his first day in Office, President Obama signed the Memorandum on Transparency and Open Government, ushering in a new era of open and accountable government meant to bridge the gap between the American people and their government. The memorandum stated:

- The Administration is reducing the influence of special interests by writing new ethics rules that prevent lobbyists from coming to work in government or sitting on its advisory boards.
- The Administration is tracking how government uses the money with which the people have entrusted it with easy-to-understand websites like recovery.gov, USASpending.gov, and IT.usaspending.gov.
- The Administration is empowering the public – through greater openness and new technologies – to influence the decisions that affect their lives.

On December 8, 2009, the White House issued an unprecedented Open Government Directive requiring federal agencies to take immediate, specific steps to achieve key milestones in transparency, participation, and collaboration.

All Open Government milestones can be tracked on the Open Government Dashboard.

Source: United States Government (2013).

d. Mobile standards

The mobility of people and use of mobile devices necessitate the provision of anytime, anywhere access to government resources. Mobile government, m-government, is the extension of e-government to mobile platforms, as well as the strategic use of government services and applications which are only possible using cellular/mobile telephones, laptop computers and wireless internet infrastructure (see Box 9.6). The benefits of m-government can include cost reduction, efficiency, transformation/modernisation of public sector organisations, added convenience and flexibility, better services to the citizens and the ability to reach a larger number of people through mobile devices than would be possible using wired internet only⁶.

Box 9.6. Examples of projects looking to design better value for money with mobile solutions

NOMAD is a pilot National Project of the United Kingdom in which 9 authorities participate. It started in November 2003. The project aims to facilitate local authorities to begin mobile computing operations and assist staff to be more productive thus reducing operating costs, improving field worker productivity and increasing processing time.

The Mobile Public services (Mobud) project started in 2004 in Berlin, Germany, in order to solve public administration problems originating in low population densities in rural areas. As a consequence public service offices were considered costly and it was difficult for people with limited mobility to visit the public service office.

The government of Canada has launched a project called "Government of Canada Wireless Portal" in order to provide people access to government information and services through web enabled devices such as web enabled mobile phones.

Sources: UK Government (2004); U., O. Schiewe (2004); Government of Canada (2006).

Relevant considerations in standard setting

Standard setting is policy making about operational management through general rules. In general this involves a trade-off between efficiency and quality of support services (see Chapter 6). In the particular area of ICT, there are large potential efficiency gains involved. Standards should lead to savings in development costs and maintenance and upgrading costs of bespoke ICT systems.

Relevant considerations in the area of ICT standard setting are:

- *International versus national standards.* With respect to the development or review and update of standards the question might arise whether international standards should be applied or national ones developed. In areas where international collaboration is important or might soon become important, international standards - when available - are in principle preferable.
- *Focus on government-wide business transformation.* Criticism is often directed at a too narrow technical view of standards. The lack of involvement of the responsible ministers (Finance, Interior or Public Administration) may lead to the adoption of standards that everybody can live with but that are not very effective in terms of efficiency gains. Focus should be on re-use, sharing and collaboration for better government. As argued in Chapter 6, standard setting is a policy making task that should not be delegated to an arm's length agency.
- *Keep it simple for the sake of innovation.* Research has shown that there is a wide variation in interoperability standards (eGIFs). At one extreme there are over 700 standards listed in the Netherlands whereas at the other end Norway has just 47 entries. Here criticism has been voiced that countries should not try to micro manage standards as it could stifle innovation.
- *Market relevance of ICT standards.* Standards need to be accepted in the market place, including a choice of suppliers whose products support the standard. The ICT sector has a diversity of voluntary, market-led, standards setting organisations with global reach. These standards setting environments have diverse structures to accommodate specific needs. Governments are often criticised that their standards become too specific and therefore create lock-in effects. Governments should therefore work with market suppliers to ensure that agreed standards will actually create value for money and then ensure that standards are included in the procurement policy to achieve wide distribution of standards (Box 9.7 for a UK example).

Box 9.7. ICT procurement rules with a focus on Value for Money in the UK

The UK has revised its ICT procurement rules to improve the share of SMEs in the supplier list and to promote innovative solutions from the market. This involves a fundamental break from large, long term contracts that restrict the department’s ability to change quickly or from tapping into innovation.

This strategy focuses on:

- Aggregating spending where possible and purchasing once as the ‘Crown’: one price for government.
- Procuring common ICT goods and services against a set of standard specifications, as defined by the Chief Information Officer community.
- Increasing efficiencies through the use of online catalogues via Government e-Marketplace.
- Developing Software Asset Management expertise to facilitate the transfer and reuse of assets.
- Improving interoperability between solutions through the use of open standards.
- Embedding full transparency in all new ICT contracts to enable effective management of the supply chain, pricing and unit costs.

Benefits:

- GBP159.6 million has already been saved in the accounting period from April 2011 to April 2012, by demanding a rigorous business case for any significant ICT spend.
- Improved pricing on contracted services to deliver verifiable cash savings for all customers.
- Standardised specifications for hardware and services are bringing price transparency for all and helping facilitate reuse/redeployment of assets.
- Software licensing optimisation is delivering savings through licence transfer and renegotiation of terms.
- Online catalogues for commodities make purchasing easier and offer Open Source alternatives for new software investments.

The UK’s Office of Fair Trading (OFT), has recently launched a study into ICT procurement by the public sector to determine the “degree of competition” between dominant providers, and to evaluate the role of SMBs in the existing procurement system.

Sources: UK Cabinet Office (2013); Smolaks (2013).

Organisation of standard setting

Standardisation of information and processes can provide significant benefits to governments through reduction in risk, increase in reuse and a higher level of interoperability (and hence efficiency) within and across jurisdictions. They support the effective delivery of services to citizens and business.

Procuring ICT that is based on standards accessible to all ICT suppliers can help promote competition among suppliers responding to public sector ICT tenders, and reduce the risk of public authorities becoming excessively dependent on a single vendor for the provision of ICT products or services beyond the timeframe of the initial procurement contract, a situation known as “lock-in”.

While established national and international standards bodies are active in delivering standards across a wide range of domains, their processes take significant time. This is partly due to the much wider range of stakeholders (international, private/public sector) and the treatment of intellectual property (IP) issues.

Since standard setting is a policy making task, it is important that it is organised within the core ministry (Finance, Interior or Public Administration). It has been argued in previous Value for Money assessments (OECD, 2010, 2011a, 2011b) that unlike support service delivery, standard setting is not an executive task and that, essential political considerations are involved. Even if the combination with service delivery tasks can be beneficial in order to ensure that standards are informed by practical experience, this should imply that the combined task units be organised inside the core ministries, rather than be put on arm's length distance. This is true both at the central level of government as a whole and at the de-central level of ministries and agencies.

Across OECD countries there is not a “one size fits all” solution to the organisation of standard setting. While governments share common challenges, they are starting from very different places in terms of technical and administrative development.

Fundamental to ICT-enabled transformation of government is the ability to construct, co-ordinate and deliver e-government across the silos of government and to ensure that government's budget, management and regulatory processes are aligned to support, rather than hinder. Organisational approaches to ICT standard setting include approaches with more administrative or political control, the latter ranging from ministerial committees to task forces in the cabinet office (Table 9.2).

Table 9.2. Broad organisational approach to e-government

← More administrative control		More political control →		
1	2	3	4	5
Ministry with specific responsibility for IT	Ministry of Finance ¹	Ministry of Interior/Public Administration ²	Ministerial board or shared ministerial responsibility	Unit/Group created by or in executive office
Belgium	Australia	Germany	Japan	Austria
Czech Republic	Canada	Greece	Korea	France
Italy ³	Finland	Luxembourg	Switzerland	Hungary
Poland	Denmark	Mexico	Slovakia	Iceland
	Sweden	The Netherlands		Ireland
		New Zealand		Portugal
		Norway		Turkey
		Spain		United Kingdom
				United States [*]

Notes: ¹ Have shared budget/finance and public administration portfolios; ² Interior (Germany, Greece). Public administration (Luxembourg, Mexico, the Netherlands, New Zealand, Spain, Norway); ³ The Italian Ministry of Innovation and Technology shares some e-government responsibility with the Ministry of Public Administration.

Source: OECD (2005).

Among leading OECD countries one can further observe the trend of the rise of the CIO or CIO board in federal countries. The 2002 survey (Accenture, 2002) of e-government leadership Accenture pointed first to the crucial role of the CIO with cross-government authority as evidence that ICT-enabled government is moving to the core of the government's agenda. Whilst CIOs have been appointed with a range of roles and responsibilities, it is widely acknowledged that advising on cross-governmental ICT standard setting responsibility is one of them (see Box 9.8 for some examples).

Box 9.8. The rise of the CIO (or equivalent)

Austria is a significant example in this regard. The “Platform Digital Austria” is the overall framework for e-Government activities and engages all levels of government; it is chaired by the Federal CIO and contains task forces and thematic working groups. Coordination at federal level and cross-cutting projects are managed by the ICT Strategy Unit.

In Germany, a new Federal IT Steering System aiming at improving IT management within the federal government has come into force in 2006. It aims to optimise Federal Administration services, enhance effectiveness and efficiency in IT-based operations and promote IT innovation. Each government ministry has a Chief Information Officer (CIO) with wide-ranging responsibilities concerning all of the ministry's IT. All CIO's of the government ministries form an IT Council and decide on all relevant strategic issues concerning the IT-steering of Germany's federal government. A high-ranking IT-Steering Group guarantees a smooth congruence between IT-issues, budgeting and overall political steering. Large-scale projects are co-ordinated centrally by the IT Steering Group. The State Secretary in the Federal Ministry of the Interior, responsible for Administrative Modernisation and Information Technology is appointed as the (first) Federal Commissioner for Information Technology.

The Federal CIO role in the USA largely focused on 1) ensuring that the USD 71 billion costs of federal ICT are spent effectively and efficiently, 2) driving a transparency and open government agenda to ensure that the public has access to information, and 3) looking at innovations that are happening in the private sector or in the NGO community and applying them to the federal government.

Sources: EC (2009, 2011); Computer Sciences Corporation (2013).

To ensure wide-spread knowledge of standards, countries have further created a range of centres or forums. For example, in the Netherlands a Standardisation Forum and Board were established in 2006 in order to promote the interoperability of the Dutch public and semi-public sectors. These institutions do not develop standards, but can assign a status (required or recommended) to existing standards.

Furthermore, there is a strong tendency that standards should be approved by a formal committee that is open to participation by all interested parties and operates on a consensus basis. In other words, a key requirement is that standards are developed, and seen to be developed, in an open collaborative, transparent manner to ensure both quality and trust. This implies a clearly defined process, timelines and decision making rules.

The standards development process should aim to maximise re-use of standard ICT components that have already been developed. And an open standard should always be publicly available and developed, approved and maintained via a collaborative and consensus driven process.

Standards-based ICT and information management allow government ICT to be driven by policy considerations and objectives such as value for money rather than by the

technology itself. It also separates technical and programme integration. Common technological standards can actually give agencies greater decision-making freedom in terms of how they deliver the programmes and services for which they are responsible.

Repeatedly, formal standardisation has been criticised for issuing standards that are not up-to-date and difficult to implement. Hence governments should apply basic principles of standard setting that the European Commission supports (Europa.EU, 2013):

- The use of ICT standards in public procurement.
- The use of ICT standards in public procurement.
- Fostering synergy between research, innovation and standardisation.
- Protection of intellectual property rights.
- Open procedures.
- Integration of fora and consortia.
- Enhancing dialogue and partnership with stakeholders.

Feasibility of the reform

Generally, centralised ICT standard setting is a key to value for money for participating OECD countries paired with a consultative open process to develop and evaluate existing standards. To avoid excessively detailed standards or out-of-date standards OECD countries should apply the following rules:

- Assess and evaluate ICT standards on a regular basis. Public authorities should also make use of the work of specialised bodies in assessing and evaluating standards, such as international, European or national standards setting bodies and the European Commission’s multi-stakeholder platform.
- Learn from other member states. A number of countries publish lists and catalogues of standards which include recommendations as to the quality and openness of the standards.
- Develop and maintain expertise on standards relevant to each area of ICT. Some countries, regions and sectors have set up competence centres on standards, in order to alleviate the need for individuals to be aware of all issues associated with the use of standards. Examples include Single Face to Industry in Sweden and the Standardisation Forum in Norway. These centres can give advice upon request, but also maintain catalogues of standards.

Reform 9 2. Common ICT process units

Characteristics of the reform

This reform consists in the merger and centralisation of ICT systems that are used in the primary process of ministries and agencies. Key areas to achieve higher value for money are basic registers, and cloud computing.

Where did it occur?

Whereas all countries participating in the study are making efforts to streamline, simplify and merge the ICT systems that are used in the primary processes of line

ministries and agencies, Denmark and the UK are at the forefront of innovation in this respect.

Analysis

Current trends

While governments continue to modernise ICT infrastructure, they are also working to merge and centralise sectoral ICT systems in order to better share information, internally and externally, to deliver integrated services and to realise savings.

In the past, government departments worked to their own requirements and often procured expensive bespoke ICT systems and solutions to meet them. As a result, departments have been tied in to inflexible and costly ICT solutions which together have created a fragmented ICT estate that impedes the efficiencies created by sharing and re-use. Many line ministries and agencies that use large scale ICT systems in their primary process are now making efforts to share or “join up” their systems with those of other ministries or agencies. In addition many OECD countries are seeking consolidation of data centres and the introduction of cloud computing.

Overview of current governance arrangements

In the 1990s, important reforms occurred in the areas of operational management in many OECD member countries. These reforms were inspired by the ideas of New Public Management. These reforms led to a substantial de-centralisation of ICT systems. ICT systems were initiated in many ministerial divisions and agencies. Recently, one can observe a certain swing back from the New Public Management reforms. This involves not only a certain re-centralisation, but the rise of enabling conditions as for instance government-wide standards for operational management.

A key subject investigated as part of the Value for Money study are large scale ICT systems that are used in the primary process of line ministries and agencies. Such systems include the basic registers of population, land, legal persons and motor vehicles that are used government wide, but also systems that are used by a limited number of ministries and agencies, such as the tax administration, the police registers, the client registers of the social security agencies, the students registers, and the registers of subsidy clients in various areas of government policy.

In most OECD countries, including the countries included in this study, the basic registers and inter-ministerial systems are not subordinated to the central ICT support unit, but to a line ministry or an agency of a line ministry. The databases are in some cases populated by information gathered from different agencies, but their operational management falls under the responsibility of a line minister. Table 9.3 provides an overview of the basic registers in the countries included in the study and the ministries to which they belong.

Table 9.3. Responsibility for central registers in selected countries

	Austria	Australia	Denmark	Finland	Norway
Total number of central registers	10	2	8	13	7
Population	Ministry of Interior	-	Ministry of Interior	Population Register Centre	Tax Directorate, Ministry of Finance
Land	Ministry of Interior	Australia Public Sector Mapping Agency	National Courts	--	Norwegian Mapping Authority
Businesses	Ministry of Economy	Australian Taxation Office	Commerce and Companies Agency	National Board of Patents and Registration	Ministry of trade and Industry, Registers
Motor vehicles	Ministry of Interior	-	-	Transport Safety Agency	Public Road Administration

Source: OECD (2012).

Many OECD countries participating in the Value for Money study now have basic registers that are organised as common process units. Common process units are characterised by the following features⁷:

- They are organised as arm's length agencies;
- The owner ministry is responsible for operational management;
- They are co-financed by the client ministries;
- Performance is supervised by a committee chaired by the owner ministry.

In Denmark most basic registers are organised as common process unit (Table 4).

Table 9.4. Overview of 8 basic registers in Denmark

	Name of electronic database (in English)	Type of data	Name of common process unit that manages the database	Employment of unit (FTEs)	Name of ministry to which the unit belongs	Other ministries that co-finance the database
1	CPR-database	CPR-numbers (Central personal register)	Part of the core ministry	18 FTEs. The actual number of FTEs is substantially larger due to local updates in the municipalities.	The Ministry of the Interior	Financed by user fees
2	The register for persons in Denmark	Registering people	Part of the core ministry	5,3 FTEs	The Ministry of Ecclesiastical Affairs	Financed by user fees
3	The register for businesses in Denmark	CVR-numbers (Central Business register)	Danish Commerce and Companies Agency	9 FTEs	Ministry of Economic and Business Affairs	Financed by user fees
4	Register for foreign providers of services	Foreign businesses operating in Denmark	Danish Commerce and Companies Agency	2 FTEs	Ministry of Economic and Business Affairs	Financed by user fees
5	The building and housing register	Data on every building and real estate	Danish Enterprise and Construction Authority	2,5 FTEs	Ministry of Economic and Business Affairs	Financed by user fees.
6	The register for real estate	Data from homeowners on their own real estate	Local government in Denmark	Not available	Independent from ministries	Not available
7	The cadastral register	Cadastral data	The National Survey and Cadastre	2 FTEs	Danish Ministry of the Environment	Financed by user fees
8	The land register	Register for private owned land	The Courts of Denmark	Not available	Danish ministry of Justice	Not available

Source: Responses to the Value for Money questionnaire.

More systematic use of common process units for ICT systems that are used by several client ministries and agencies contributes to improved service quality, in particular for other ministries and agencies than the owner ministry and better incentives for cost control.

In the case that an ICT system is used government-wide, such as the basic registers, transfer of the ICT system to the central support unit (in the Ministry of Finance, Interior or Public Administration, etc.) should also be considered. This implies that the system becomes part of the primary process of the support unit in a similar way as a government wide portal and that its budget is transferred to the central support unit. That the Minister under which it resorts (Finance, Interior or Public Administration) takes over the responsibility for operational management.

Centralisation, modularisation and consolidation of ICT processes

Scalable and modular solutions are indispensable today in ensuring the efficient and cost-effective use of the ICT infrastructure. Governments must process and store ever-increasing amounts of data in their daily operations. This requires more powerful data storage, processing and transmission, securely and without interruption. As this becomes increasingly complex it leads to outsourcing and external hosting. Moreover, cost reduction is a major concern for OECD countries. Using redundant, scalable and modular solutions serves to improve the availability, security and the gradual expansion of the systems.

Cloud computing delivers hardware, services, and software via the network on demand. Cloud computing transforms once-expensive capital assets like disk storage and processing cycles into a readily available, affordable commodity. The major driver of cloud computing has been the recognition that large data centres do not operate at full capacity, creating a surplus of computing resources. By using these resources more efficiently, cloud computing enables greater returns on data centre investments. The primary savings would come from data centre consolidation and aggregation of demand.

Box 9.9 and 9.10 provide information about cloud based reforms that have been initiated in the US and the UK.

Box 9.9. Cloud Computing strategies in the US

The US Federal Budget for 2011 has incorporated cloud computing as a major part of its strategy to achieve efficiency and reduce costs. It states that all agencies should evaluate cloud computing alternatives as part of their budget submissions for all major IT investments, where relevant.

Specifically:

- By September 2011 – all newly planned major IT investments acquisitions must complete an alternatives analysis that includes a cloud computing based alternative as part of their budget submissions.
- By September 2012 – all IT investments making enhancements to an existing investment must complete an alternatives analysis that includes a cloud computing based alternative as part of their budget submissions.
- By September 2013 – all IT investments in steady-state must complete an alternatives analysis that includes a cloud computing based alternative as part of their budget submissions.

To fast track adoption, the US General Services Administration has established a portal dedicated to cloud computing applications for the public sector. The portal: www.apps.gov provides the public sector agencies with the common platform for the procurement of cloud services – SaaS and IaaS – from recommended services providers.

Sources: Kundra (2010); Lohrmann (2010).

Box 9.10. G-Cloud and App-store in the United Kingdom

The UK Government established an UK onshore, private Government Cloud Computing Infrastructure called G-Cloud. The UK Government G-Cloud is an initiative targeted at easing procurement by public sector bodies in departments of the United Kingdom Government of commodity information technology services that use cloud computing. In June 2013 G-Cloud moved to become part of Government Digital Service (GDS) with the director becoming Chief Technology Officer of the Home Office.

The government published a strategy that states that the UK will adopt a “public cloud first approach” to procurement with a view to saving GBP 340 million between now and 2015. The cloud-first strategy is spearheaded by a G-Cloud Delivery Board, which comprises a cloud services group, a security working group, a commercial working group and a data centre consolidation project board. The Delivery Board will work alongside a G-Cloud Authority, which will oversee the longer term take up and assurance of commodity services. The service began in 2012, and had several calls for contracts. By May 2013 there were over 700 suppliers - over 80% of which are small and medium enterprises. GBP 18.2 million (USD 27.7 million) of sales were made by April 2013.

Much of the government’s G-Cloud work will focus on the consolidation of data centres, through which the government hopes to save GBP 20 million in 2012-13, GBP 60 million in 2013-14 and GBP 80 million in 2014-15.

Currently, it is estimated that the government is only using 10% of its data centre capacity, so the scope for savings is large. The government said it will monitor progress by looking at the number of data centres and associated hosting services in use as well as the cost per service.

The G-Cloud consists of: a series of framework agreements with suppliers, from which public sector organisations can call off services without needing to run a full tender or competition procurement process and an online store, the "CloudStore", that allows public sector bodies to search for services that are covered by the G-Cloud frameworks.

An essential part of the G-Cloud strategy will be the creation of a government app store, which serves both central and local government and be populated by competing services. Its key tasks are to:

- provide an open, visible, commoditised and cost transparent marketplace, that is the first point of call for any public sector ICT requirement;
- create a shop window where all the relevant public sector ICT services can be found encouraging innovation, competition and new suppliers;
- enable the information assurance and security community to have access to information related to the assurance and accreditation status of the service;
- be a key enabler for collaborative procurement, including:
 - driving up supplier performance by providing an open feedback mechanism;
 - facilitating re-use of a service to drive efficiency and cost savings.

Source: UK Government (2013).

Feasibility of the reform

The deployment of effective E-Government requires a coherent approach that aligns all government entities toward the provisioning of customer-centric e-services. To meet

this goal, they need to build common secure infrastructure, but also to prioritise co-operation between line ministries and agencies in common process units.

This approach requires the development of a plan, in the form of an ICT strategy for instance, which ensures that ministries combine their efforts, underpinned by rigorous controls and mandates. This will deliver the greatest savings benefits and provide the critical foundations to enable the re-use and sharing of solutions and services.

Different OECD countries have different maturity levels when it comes to their ICT systems. As most efficiency can be achieved by centralisation, modularisation and consolidation of ICT processes, countries need to identify the sectoral systems that can be shared. Common ICT process units enable large-scale deployment of public e-services rapidly on the basis a secured, scalable, and centralised ICT systems.

It is critical that procurement and contracting procedures are available to support this new model of ICT delivery and maximise the speed of implementation, and that the contracting landscape is clearly understood in order to fully ensure compliance.

Reform 9.3. Gateway procedures

Characteristics of the reform

This reform consists of the establishment of a special procedure for *ex ante* evaluation of ICT investments above a certain threshold by experts who have no stake in the project (gateway procedures). The aim of a gateway procedure for ICT projects is to provide information for the go/no go decision and keep the projects on track.

Countries where it occurred

OECD governments are working to improve the ICT governance structure to assist project managers in assessing and improving their capability to commission, manage and realise the benefits of ICT investment. Australia, the UK and Denmark belong to the countries that have introduced gateway procedures for ICT investments following a different approach. Whereas the Australian and UK procedures put emphasis on a step by step procedure aimed at providing guidance to the project team and the responsible minister or agency head, the Danish procedure puts emphasis on the business case and the requirement of savings.

Analysis

The reputation of government ICT project management has suffered from repeated high-level failures in many OECD countries. Numerous reports and articles have pointed to a long list of problems. To name but a few: chronic project delays; suppliers failing to deliver on their contractual commitments; not designing with the user in mind; divergent costs for simple commodity items; incompatible systems; the high cost of making even basic changes; “gold-plating” IT solutions; and failing to reuse existing investments. Moreover, there is a critical dependence on legacy systems⁸, and the need to deal with interoperability between these systems increases cost and complexity.

ICT projects come in very different sizes and fail for many reasons, including a shift in political priorities. For instance, in the UK particularly the attempt to digitize the NHS has had some spectacular project failures. The current government for instance scrapped a GBP 12 billion NHS national computer scheme only recently (Daily Mail, 2011). When the conservative government took office in 2010, it also stopped the GBP 4.5 billion

national electronic identity card scheme. The government said the move would save GBP 86 million over four years and avoid GBP 800 million in costs over the next 10 years that would have been raised by increased charges (The Guardian, 2010). It is difficult to get a full picture of ICT failure across OECD countries. Respondents to the questionnaire issued in 2009 highlighted that such data are not available, but anecdotal evidence points to the contrary.

Many researchers have identified the challenges associated with the *ex post* evaluation of ICT projects. These challenges apply even more to *ex ante* evaluation when evidence on effects is not yet available and must be estimated. Nevertheless, *ex ante* evaluation is essential, exactly because of the huge costs of failures. In general, governments are using *ex ante* evaluation procedures, in particular Cost-Benefit Analysis and Regular Impact Analysis in cases where failures can lead to large costs on society (see Reform 3.6), but for ICT projects special procedures are required in view of the complicated technical aspects.

Criticism of gateway procedures has included that guidelines with respect to ICT projects are not always kept up-to-date and hence can lead to lack of flexibility and lack of relevance.

Box 9.11 and 9.12 provide information about the gateway procedures established in the UK, Australia and Denmark.

Box 9.11. The Gateway Review process in the UK

At the heart of the UK approach is the Gateway Review Process™ (OGC 2005). This process was developed after a review in 2003 showed great disparity in the quality of e-government business cases. Business case guidance and new tools were developed in response to these findings. The Gateway process became the standard procedure for ensuring that these tools were used.

The OGC Gateway Process examines programmes and projects at key decision points in their lifecycle. It looks ahead to provide assurance that they can progress successfully to the next stage; the Process is widely used in central government, the health sector and local government. The process is mandatory for ICT procurement OGC Gateway Reviews deliver a ‘peer review’, in which independent practitioners from outside the programme/project use their experience and expertise to examine the progress and likelihood of successful delivery of the programme or project. They are used to provide a valuable additional perspective on the issues facing the internal team, and an external challenge to the robustness of plans and processes.

The OGC Gateway Process provides support to senior managers, and helps them to ensure:

- the best available skills and experience are deployed on the programme or project;
- all the stakeholders covered by the programme/project fully understand the programme/project;
- status and the issues involved;
- there is assurance that the programme/project can progress to the next stage of development;
- or implementation and that any procurement is well managed in order to provide value for money;
- on a lifecycle basis;

Box 9.11. The Gateway Review process in the UK (*continued*)

- achievement of more realistic time and cost targets for programmes and projects;
- improvement of knowledge and skills among government staff through participation in Reviews;
- provision of advice and guidance to programme and project teams by fellow practitioners.

The results of the Gateway procedure are not made public. They are carried out at the request of the programme/project director and include a confidential report on the status of the project delivered to the authority that is responsible for the programme/project. The decision to keep reports confidential is an important ingredient to the success of the whole process, ensuring full and open participation from the project team during the review.

Since its inception, over 1700 Gateway reviews have been conducted in the UK. The effectiveness of the Gateway Process has been endorsed in the 2007 Treasury report on “Transferring Government Procurement”

Sources: UK Government (2007); OECD (2007a).

Box 9.12. The Gateway Review Process in Australia

In November 2005, the Australian Government endorsed, through Cabinet decision, the adoption of the Gateway Review Process™ (Gateway) of the United Kingdom’s Office of Government Commerce (OGC) in order to reinforce the capability of ministries and agencies to implement ICT projects. The Gateway process is led by the Department of Finance and Deregulation. In 2011, in recognition of the complexity and implementation challenges that can accompany programme delivery, particularly cross-portfolio programmes, the application of Gateway assurance methodology was extended to apply to programmes as well as projects. This underpins a more complete application of the assurance methodology across government, thereby supporting policy delivery.

The Gateway Review process applies to new projects undertaken by FMA agencies operating under the Financial Management and Accountability Act 1997 (FMA Act), which satisfy certain financial and risk thresholds. The current financial thresholds are:

- Projects of AUD 30 million and over including an ICT component of at least AUD 10 million; or
- Projects of AUD 30 million and over for other procurement and infrastructure projects; or
- Programmes with a total cost greater than AUD 50 million.

These thresholds apply to the total value of a project, regardless of the timeframe taken to deliver the objectives.

Source: Australian Government (2012).

Gateway strengthens the oversight and governance of major projects and assists governments to deliver new projects in accordance with the stated objectives, on-time and on-budget. It achieves this by providing an arm's length assessment of a project at critical stages of the project's lifecycle.

In Australia, lessons learnt reports regarding the gateway procedure are published regularly. The publication “Assurance Reviews Process – Lessons Learned Benefits Realisation Management” was released in July 2012. Based on the observations arising from the Australian Government’s Assurance Review Processes (including Gateway), it was developed to assist agencies to better identify opportunities for improving their Benefits Realisation Management practices. Guidance is provided to programme and project managers on how to apply a benefits management approach through the conception, pre-decision, implementation, and post-implementation phases.

The business case procedure used by the Ministry of Finance in Denmark on the other hand delivers a financial overview and allows the users to compare estimated benefits and costs for the government (Box 9.13). The model is based on international standards for ICT projects and business cases. Allegedly, the focus on costs and benefits for the government makes it somewhat easier for projects that aim at efficiency gains in administrative processes to get the green light than for projects that aim at broader aims. This may hamper the harvest of the full benefits from e-government projects. On the other hand this focus on measurable costs and benefits for the government fits in well with the demands of a budget procedure that is based on strict budgetary discipline. Such a procedure typically puts different requirements on proposals that lead to savings on the government budget than on proposals that lead to new spending, the latter being subject to trade off against other proposals for new spending and against tax relief (see Chapter 7, Reforms 7.2 and 7.3).

Box 9.13. The gateway procedure in Denmark: general business case methodology

Denmark uses a general business case methodology: a tool for better and more transparent decision making and effects measuring. The general business case model is regarded as an evaluation and monitoring tool for value-creating investments. The model balances costs, benefits and risk and it requires the use of the methodology continuously throughout the project cycle.

Since April 2008, the use of the general Denmark Business model has been mandatory to use for all central government agencies when starting up new ICT projects with budget equal to higher than DKK 10 million. The methodology is further recommended for the steering of ICT projects as subnational level. However, a recent OECD review of e-government in Denmark (2010) also found that “small” budget projects (below DKK 1 million) tend to use the business case methodology.

Initially used mainly with the purpose to improve project design and value, the business case model actually contributes to the improvement and decentralisation of project management, establishes a common understanding of what value is, and ensures that investments lead to economic or qualitative effects which can be measured.

One main limitation however is, that the business case model is precise and detailed regarding the financial measurements and requirements but less detailed regarding the more societal, qualitative and policy oriented benefits. From the point of view of budgetary discipline and the need to make a distinction between projects that lead to savings and new spending initiatives this does not need to be seen as a disadvantage.

Sources: Danish Government (2007); OECD (2010).

The OECD report on benefits realisation management (OECD, 2007a) found that the advantages of gateway procedures include:

- Gateways are a useful part of the project appraisal process and an opportunity to stand back and take an objective look at the programme.
- Review results identify well-articulated areas for improvement and highlight programme strengths.
- The process is viewed as flexible and supportive rather than prescriptive and rigid.
- The process does not significantly delay projects or programmes, and any delays that do occur are seen as positive steps towards making the business case stronger.
- Projects take place in the broader legal and institutional contexts that determine their ability to deliver on efficiency goals.

In other words, it was found that the gateway procedures are particularly strong on reviewing programme governance, personnel, management and risk management. However it also found that most of these procedures placed less emphasis on detailed financial scrutiny of business cases and evaluation of customer propositions, or the successful delivery of customer benefit.

Feasibility of the reform

It is now increasingly recognised that the adoption of a benefits realisation programme can be an important mechanism for proactively managing IT development projects, so that they more explicitly focus upon the delivery of value over a systems operational life. Gateway procedures can be an important element in benefits realisation management.

OECD countries should evaluate the pros and cons of different gateway procedures available. The Danish business case approach is particularly relevant for countries that practice a budget procedure based on strict separation between baseline spending and spending for new policy initiatives.

Notes

1. See for example the recent Report by National Audit Office UK on ICT: *“The impact of government’s ICT savings initiatives”* (National Audit Office of the UK, 2013).
2. Definition of “lean government”: http://en.wikipedia.org/wiki/Lean_Government
3. Quoted in a Microsoft Insight Report (2010).

4. Find out more about reviews and other services offered by the OECD Public Sector Innovation and e-government unit here: www.oecd.org/departement/0,3355,en_2649_34129_1_1_1_1_1,00.html
5. In particular it covers standards 5 to 8 mentioned in the introduction.
6. See definition and additional information about m-government here: <http://en.wikipedia.org/wiki/M-government>.
7. See chapter 4, Reform 2.
8. Definition by Tromp and Hoffman [2003] : “*A legacy system is an operational system that has been designed, implemented and installed in a radically different environment than that imposed by the current IT strategy*”. Said in a slightly different way: legacy systems utilize outmoded programming languages, software and/or hardware that typically are no longer supported by the respective vendors.

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Chapter 10

Internal audit management

Internal audit is the monitoring component of internal control. It is aimed at minimising the probability of the occurrence of error, inefficient and uneconomic practices or fraud. Internal audit contributes to value for money in government if this aim is achieved at a reasonable cost. This chapter presents three reforms that lead to better results of internal audit at lower costs.

Independence of the internal auditor is an essential condition for effective audit reports. A first reform shows how the independence of the internal auditor can be assured.

The second and third reforms address the task package of the internal auditors and the criteria for the need and size of internal audit units. Limiting the task package by eliminating regularity audit and certification, and strict criteria for need and size of internal audit units can in many countries lead to substantial savings.

Introduction

What is internal audit?

Internal audit has developed over the previous decade as a managerial support service aimed at reducing risk. Internal audit is seen as a component of the broader concept of “internal control” which refers to all managerial activities aimed at “minimising the probability of the occurrence of error, inefficient and uneconomic¹ practices or fraud” (INTOSAI, 2004). In this view internal audit is seen as the monitoring component of internal control and part of an organisation’s internal control structure.

The function of internal audit (IA) in the public sector will lead to value for money if the audit activities have impact at a reasonable cost. Impact means that IA adds value by helping the management of ministries and agencies in mitigating the risk of occurrences of errors, inefficient and uneconomic practices, or fraud. Basic requirements for effective internal audit are 1) that internal auditors can act sufficiently independently, 2) report to decision makers and 3) that quality of their work is ensured.

Sufficient independence

Internal auditors are not fully independent unlike external auditors in the public sector who belong to the Supreme Audit Institution (SAI). Internal audit is a support service for management. However, in order to be effective, internal auditors should have sufficient independence to warn management for risk, even in circumstances where their warnings are not welcome. In most OECD countries internal auditors are civil servants and have to agree their work programme with the top-management of the organisation. However, their functional and operational independence should be guaranteed, preferably by law. This implies that they should have no operational responsibilities, be positioned at the top of the organisation, and be able to carry out their work in freedom and objectively.

Reporting to decision-makers

Internal auditors should report to decision makers to have impact. But who is the decision maker? Internal auditors report normally to the top of the organisation: to the minister or top civil servant of a ministry or the managing director of an agency. Of course, the right to report to top management does not, in practice, guarantee that recommendations of internal auditors are followed up, but then internal audit is a support service, and the ultimate responsibility for the minimisation of risk rests with management.

Assurance of quality

The evolution of the internal audit function in the public sector has led to a more professional audit approach. Internal auditors are trained in auditing, however mostly in auditing of private sector organisations. To assist management of public sector organisations effectively (and have impact) audit reports should focus more on the key risks of public sector organisations, which are different from those of private sector organisations. Compliance with laws and regulations is of course a key factor, but internal auditors will be more and more involved in (financial) management problems more broadly. Classical public finance expertise is needed but also for example knowledge of policy and decision making processes in a political environment, of new budget practices, and of the security of large ICT systems. Some OECD countries have experienced the

lack of this type of knowledge and skills and have started with specific education programmes for internal auditors in the public sector.

Two types of audit

Internal audits are of two types:

- Compliance audit: this type of audit verifies that financial management complies with the appropriations of the budget laws and other regulations, private contracts concluded and customary practice;
- Performance audit: this type of audit assesses the economy of input, the efficiency of output, and the effectiveness of government's policies in relation to outcomes.

In some OECD countries the tasks of internal auditors also comprises the audit of the government's annual accounts (financial or regularity audit), resulting in a statement that these accounts provide a "true and fair view" (certification), although that task is internationally not regarded as a core task of internal audit.

In principle the objectives and tasks of internal audit and of external audit are the same. Both aim to support the Government (and in the case of external audit: the Parliament) in mitigating the risk of occurrences of errors, inefficient and uneconomic practices, or fraud. However, their legal status and reporting line is different. The independence of a SAI is mostly guaranteed by constitution or by law and the main customer of the SAI products is the national Parliament. The independence of internal audit is guaranteed by law or by Government decree and internal auditors report to senior management of an organisation. However, SAIs also provide an annual opinion on the ministry's or agency's financial accounts (financial audit and certification), besides carrying out compliance and performance audits. Internal auditors usually do not.

Internal auditors and SAIs often co-ordinate their activities. This coordination may include exchange of plans and reports, and co-operation on methodology and training, and does not compromise the independence of external audit, nor does it shut down the reporting line of IA to management (EC, 2012 and INTOSAI, 2010b).

Internal audit standard setting

In OECD countries internal audit standards are developed by Ministries of Finance (MoF). In OECD countries, that are also European Union members, standard setting is a task of a so called Central Harmonisation Unit within the MoF. In countries where internal audit has been recently introduced national governments have developed standards for which international standards were often the basis.

Most well-known international internal audit standards are developed by the Institute of Internal Auditors (IIA), which publishes the "International Standards for the Professional Practice of Internal Auditing" (IIA, 2010). Although they primarily focus on private organisations, some guidance documents for public governments have been developed as well (OECD, 2011b).

A noticeable development in recent years is that national laws or regulations on internal audit refer to recognised international standards and good practice (EC, 2012).

Reforms of this chapter

This chapter focuses on three reforms:

1. The first is ensuring the independence of the internal auditor. The internal auditor's position should be strong and clear. Regulation of the internal audit function in the public sector in a law or secondary legislation is important. A good example of a country with a well-balanced law is Canada.
2. The second reform concerns defining criteria for need and size of internal audit units. The value for money study indicates that there are differences in size of internal audit units. Internal audit is a support service, which is an important help for management in mitigating (financial) risks. It must in itself operate in an efficient way. Finding the balance between large bureaucratic internal units and ineffective small units is the real challenge. Sweden is an inspiring example.
3. The third reform is related to the core task of internal audit: to assist management in achieving its objectives with the least possible risks. There are countries that have assigned other tasks to internal audit units too, such as the task of certification of financial statements. This can lead to overlap with the tasks of SAIs (Netherlands/Denmark). Canada is a good example where the tasks of IA are clearly defined.

Reform 10.1. Ensuring independence of Internal Audit

Characteristics of the reform

The reform consists of clearly regulating the independence of internal audit in the public sector. By ensuring independence and access to top management internal audit will be in a strong position when it comes to objectively advising management on risk of occurrences of errors, inefficient and uneconomic practices, or fraud.

Where did it occur?

The ten countries participating in the Value for Money Study provided information about the legal basis of the IA function. The IA function is regulated by law in nearly all countries and mostly through the Budget Code or similar laws on government accounting or financial management (Australia, Austria, Canada, Finland, Netherlands, New Zealand, and Spain). The Northern European countries Denmark, Norway and Sweden have made other legal arrangements. Table 10.1 provides an overview of the legal basis and reporting line of Internal Audit.

Table 10.1. Internal Audit Legislation

	Legal basis	Criteria establishment IA unit	IA report addressed to	IA report to SAI
Australia	FMA Act and CAC Act**	At the discretion of Head of ministry or agency	Head of ministry or agency	Not all reports
Austria	Federal Law on the Competencies of the Ministries (<i>Bundesministeriengesetz</i>)	IIA standards	Minister or Head of agency	50 % of reports
Canada	Financial Administration Act Law and Policy on internal audit	Government Policy on internal audit	Deputy Head via the Departmental Audit Committee with a copy to the Office of Comptroller General	All reports
Denmark	Auditor General Act	Auditor General Act	Head of ministry or agency and SAI	All reports
Finland	Central Government Budget Act and Central Government Budget Decree	Head of ministry or agency	Head of ministry or agency	All reports
Netherlands	Government's Accounting Act	n.a.*	Minister and head of agency	90% of reports
New Zealand	Public Finance Act	Head of ministry or agency	Head of ministry or agency and Audit Committee	n.a.*
Norway	Financial Management Regulation of Ministry of Finance	Head of ministry or agency	Head of ministry or agency and other officials	75 % of reports
Spain	General Budget Law	n.a.*	Minister and head of agency	25% of reports
Sweden	Government Ordinance on internal audit	At the discretion of the Government	Head or Board of Agency and head of ministry	All reports

Notes: *Data not available; ** Financial Management and Accountability Act 1997 and Commonwealth Authorities and Companies Act 1997.

Source: Responses to the Value for Money questionnaire.

Analysis

It is internationally agreed that internal audit must be independent, and internal auditors must be objective in performing their work (IIA, 2010). This means that the internal audit activity must be free from interference in the determination of the scope of work, the performance of work, and the communication of results to senior management. Independence is also the freedom from conditions that threaten the ability of the internal auditors to carry out internal audit responsibilities in an unbiased manner. To achieve the degree of independence necessary to carry out the responsibilities of the internal auditor effectively, the head of the IA unit should have direct and unrestricted access to senior management. Objectivity is an unbiased mental attitude that allows internal auditors to perform their tasks in such a manner that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others.

In the public sector the IA staff are subordinate to the minister/head of ministry (permanent secretary or secretary-general) or chief executives of agencies. It is in the interest of the management of ministries and agencies that the internal auditor can operate in full freedom. Ensuring their independence should ideally be anchored in a separate law, although this is not directly necessary to guarantee independence. None of the ten

countries in the Value for Money study have regulated IA in a separate law but eight countries have specific framework articles about the internal audit function in their Organic Budget Laws or Financial Management laws. Norway and Sweden have regulated IA only in secondary legislation.

Ensuring independence means that the role and responsibilities of the head of the IA unit and IA staff are clearly defined. The procedure for the appointment and dismissal of at least the head of an IA unit should contain special guarantees. In the event that a minister or a chief executive of an agency is entitled to appoint and dismiss the head of an IA unit the Ministry of Finance, the Audit Committee, if one exists (see below), and possibly the Supreme Audit Institution should be involved. The legal framework of Canada may function as an example of how IA and its independence could be regulated. The legal framework is provided by the Policy of Internal Audit which is set out by the government's Treasury Board.

The Policy directly supports and recognises the role and responsibilities of deputy heads of ministries and agencies as accounting officers, as laid out in Part I.1 of the Financial Administration Act. While deputy heads are responsible for the management of their departments, the Policy provides a clear and integrated assignment of responsibilities for internal auditing between deputy heads and the Comptroller General who supports strong internal auditing across government.

Boxes 10.1 and 10.2 provide more information about the main responsibilities concerning internal audit in Canada.

**Box 10.1. Policy requirements for Deputy Heads of
Departments related to Internal Audit**

Deputy heads of all departments are responsible for:

Ensuring that internal audit resources are sufficient to achieve the risk-based internal audit plan

Deputy heads of large departments are responsible for:

Establishing and maintaining an independent departmental audit committee that includes a majority of external members recruited from outside of the federal public administration. An independent and objective perspective is essential to the audit committee members' capacity to challenge and effectively assess their key areas of responsibility.

Appointing a qualified chief audit executive, reporting directly to the deputy head, to lead and direct the internal audit function.

The deputy head should ensure that:

The chief audit executive (CAE):

- Is not assigned any departmental management or operational responsibilities which may compromise the independence and objectivity of the CAE in respect of the CAE's internal audit responsibilities;
- Has unfettered access to the departmental audit committee and to the committee chair and/or vice-chair;

Box 10.1. Policy requirements for Deputy Heads of Departments related to Internal Audit (continued)

- Has access to all departmental records, databases, workplaces and employees, and has the authority within the context of carrying out its departmental risk-based audit plan or other engagements to obtain information and explanations from departmental employees and contractors; and
- Has unimpaired ability to carry out his or her responsibilities, including reporting findings to the deputy head, to the departmental audit committee and, as appropriate, to the Comptroller General.

The Comptroller General or his or her representative:

- Is a member of the selection committee during the CAE's appointment process;
- Is advised of the appointment, transfer or departure of the CAE; and
- Is consulted on the proposed position description of the CAE.

The Comptroller General:

- Is consulted on the establishment of clear responsibilities and performance expectations for the CAE;
- Is consulted on the periodic performance evaluation of the CAE; and
- Is consulted on the intention to remove a CAE for reasons relating to the CAE's professional performance.

Source: Provided by the Treasury Board of Canada Secretariat.

Box 10.2. Responsibilities Comptroller General related to internal audit

The Comptroller General is responsible for:

Providing government-wide functional leadership of internal auditing

Providing leadership and having measures in place to support the capacity, proficiency and sustainability of the internal audit community government-wide.

Determining the professional standards for internal auditing in the federal government.

Providing advice, guidance and support on the application of the Policy on Internal Audit and related instruments.

Supporting the establishment and operation of appropriately qualified audit committees, as well as providing guidance on expected audit committee practices government-wide.

Establishing competency profiles to guide the recruitment of external audit committee members and establishing or proposing other requirements related to the terms and conditions of appointment for audit committee members.

**Box 10.2. Responsibilities Comptroller General
related to internal audit (*continued*)**

Identifying and communicating to deputy heads through a risk-based horizontal audit plan internal audits to be considered for inclusion in departmental risk-based internal audit plans.

Establishing an independent Small Departments Audit Committee to provide the Comptroller General with guidance and advice on internal auditing in small departments.

Leading internal audit engagements in small departments and those that address government-wide, sectoral or thematic risks or issues identified in the government-wide risk-based internal audit plan.

Source: Provided by the Treasury Board of Canada Secretariat.

The independence of internal audit could be strengthened if an Audit Committee is established. The tasks of audit committees can differ. Their task can be limited to reviewing external and/or internal audit reports but can also be much broader. In Canada for example the Departmental Audit Committees provide objective advice and recommendations to the deputy head regarding the sufficiency, quality, and results of assurance of the department's risk management in general.

To be of value for ensuring the independence of internal audit, members of audit committees should preferably be independent of the public administration. In Canada Audit Committees must include a majority of external members recruited from outside of the federal public administration (see Box 10.3). Diversity of experience is encouraged. Members of an audit committee are selected so that their collective skills, knowledge, and experience will allow the committee to competently and efficiently undertake its duties. Committee membership from within the federal public administration is limited to individuals at the level of deputy head. Audit Committee members are jointly selected by the deputy head and the Comptroller General and their appointment is approved by the Treasury Board.

Box 10.3. Tasks of large departmental audit committees in Canada

Task Internal Audit Function (Directive on Internal Auditing in the Government of Canada, 1 April 2012):

- recommend, and periodically review, a departmental internal audit policy or charter for the approval of the deputy head;
- provide advice to the deputy head on the sufficiency of resources of the internal audit function;
- review and recommend for approval a multi-year risk-based internal audit plan;
- monitor and assess the performance of the internal audit function;
- provide advice to the deputy head on the recruitment and appointment, as well as the performance of the chief audit executive;
- review and recommend for approval internal audit reports and corresponding management action plans to address recommendations;
- review regular reports on progress against the risk-based internal audit plan; and
- be made aware of internal audit engagements or tasks that do not result in a report to the committee, and be informed of all matters of significance arising from such work.

Source: Provided by the Treasury Board of Canada Secretariat.

The independence of internal auditors can further be enhanced by the status of employment (INTOSAI, 2010a). In general it is recommendable that they have the status of civil servant (with all protection implied by that status).

Supreme Audit Institutions could be a “line of defence”. In the Netherlands the appointment and dismissal of a Head of an internal audit unit has to be approved by the Dutch Court of Audit. In Denmark Heads of IA units are appointed by the Danish National Audit Office (“*Rigsrevisionen*”).

Feasibility of the reform

The independence of at least the heads of internal audit units should be guaranteed. A strong position in an organisation, access to top-management and protection by several legal safeguards will strengthen the internal audit function in its task to support management with objective recommendations on risks of occurrences of errors, inefficient and uneconomic practices, or fraud.

The Canadian example shows that a combination of several measures can ensure the necessary independence of the IA function. Countries where internal audit has not been organised as it has been in Canada, strengthening of the position of internal audit may be considered. Countries where internal audit is not regulated by law may consider to do so.

Reform 10.2. Criteria for need and size of internal audit

Characteristics of the reform

The role of internal audit in OECD Member countries has evolved over the last two decades. From a transaction oriented ex-post control activity with focus on compliance and regularity, it now concentrates more on evaluating and mitigating risks.

This development has occurred in the private sector as well as in the public sector and has been stimulated by external developments such as the introduction of new Control Framework of Committee of Sponsoring Organisations of the Treadway Commission (COSO) in 1992, and the accession of former socialist countries to the European Union. However, the extent to which the development of new views on internal audit have impacted on the size of the internal audit capacity turns out to be very different between countries. The Value for Money perspective, that is the point of departure for the present study, should also be applied to internal audit capacity. Internal audit units should only be established where there is a real value for money justification and, if established, it should have critical mass. The implications of IA ‘new style’ have not always been well considered and taken into account. This reform focuses on the necessity of defining criteria for the need and size of internal audit units in public sector organisations.

Where did it occur?

Australia, Canada and Sweden are the only countries participating in the study where criteria have been defined for the government as a whole. Only in Sweden was the criteria are defined in a way that requires justification of costs and benefits in separate cases. This has led to a relatively small size of the total internal audit capacity in that country.

Analysis

Size of the internal audit capacity

The ten countries participating in the Value for Money Study all provided information about the organisation and size of the internal audit function. In nearly all countries participating in the study internal audit is decentralised except in Spain, where it is centralised in the Ministry of Economy and Finance. The size of the internal audit function varies from 769 in total in the Netherlands to 33 in Finland, and from 25-40 per unit in the Netherlands to 1-4 per unit in Finland or Norway. Clear criteria for the need and size of internal audit units in separate, concrete cases are not well defined, except in Sweden. In most countries it is up to the management of the ministry or agency to decide about the establishment and size of the IA units. Table 10.2 provides an overview of the organisation and numbers of IA staff in the participating countries in the Value for Money study.

Table 10.2. Internal Audit Organisation and Staff

	Organisational structure of internal audit	Setting criteria for establishment of internal audit unit	Number of internal audit units in ministries	Size of total internal audit staff central government	Of which Support staff
Australia	Decentralised	Head of ministry or agency	From 8 to 1 **	227	42
Austria	Decentralised	IIA standards	From 2 to 1	100	10
Canada	Decentralised	Policy of IA of Treasury Board	1	525	75
Denmark	Decentralised	Supreme Audit Institution	More than 1	80	*
Finland	Decentralised	Head of ministry or agency	1	33	0
Netherlands	Centralised (4 ministries) and decentralised (rest of ministries)	*	From 3 to 1	769	124
New Zealand	Decentralised	Head of ministry or agency	*	*	*
Norway	Decentralised	Head of ministry or agency	In 13 agencies	26-52	*
Spain	Centralised (Ministry of Economy and Finance)	*	*	180	*
Sweden	Decentralised (in agencies)	Government decision	In 61 agencies	124	3

Notes: * Data not available; ** There are 194 internal audit committees: 104 under the FMA Act and 90 under the CAC Act
 Source: Responses to Value for Money questionnaire.

Under the influence of New Public Management the establishment of internal audit units in most of the countries participating in the Value for Money study is left to the management of the ministry or agency. In some other countries the establishment of internal audit units has to comply with certain general criteria laid down in law or by-law (Australia, Canada, Sweden).

In Australia and Canada this has led to a relatively large capacity of internal audit, without need for the ministries and agencies concerned to justify added value in separate cases. In Sweden, establishment of an internal audit unit requires government approval in separate cases. In practice Norway comes next to Sweden in this respect. The countries are cautious in establishing IA units. Where they have been established the units are mostly of a small size (2-4 staff or even 1 person). This risk approach to the establishment of internal audit is sensible and efficient. However, this cautious approach should still be based on explicit and transparent criteria. Such criteria should not be too general, for instance only looking at the total expenditures of the ministry or agency, but should reflect the concrete risks the ministry or agency is facing in view of its tasks, policies, expenditures and revenues. In practice the establishment of internal audit units can best be taken in consultation with the central standard setter in the Ministry of Finance (often called harmonisation unit). This unit is best equipped to weigh the costs of IA capacity against the benefits (see Reform 6.2).

Centralisation or decentralisation

In most countries internal audit support services are decentralised over ministries and agencies. This reflects the need for internal auditors to have direct access to heads of ministries and agencies and to gain the confidence of the senior management. However, in Spain and in the Netherlands internal audit support services are concentrated in one unit for the whole of central government.

In the Netherlands the central internal audit unit has the character of a shared service centre. As a consequence of a governmental efficiency programme the Netherlands started in 2010 to concentrate internal audit units of four ministries in one governmental Audit Service. This was part of a wider effort to concentrate support services, including ICT, human resources and accommodation in shared service centres in order to benefit from economies of scale and specialised expertise. This process of internal audit centralisation will continue until all internal audit units are centralised under the umbrella of the Ministry of Finance. Compared with other countries participating in the study the number of internal audit staff in the Netherlands is relatively high. However, a core task of internal audit in the Netherlands is certification of the annual ministerial financial statements and not supporting management in mitigating the risks of occurrences of errors, inefficient and uneconomic practices, or fraud. If the task of internal audit would be reduced to supporting management in mitigating their risks, the size of internal audit staff could be substantially reduced (see Reform 10.3). Moreover, concentrating the internal audit task in a single shared service centre might be understandable from the point of view of financial certification, but is more problematic from the point of view of risk management, which requires a confidence relation with the management of ministries and agencies.

Similar observations can be made about Spain, where internal audit is also concentrated for the whole of government. In that country too, internal audit is tasked with certification of financial statements next to compliance and performance audits, and the IA capacity is relatively large.

Feasibility of the reform

A thorough analysis of the need for establishing an internal audit unit in ministries and agencies and about the minimum size of the unit to be effective could help all countries participating in the Value for Money study in defining the optimal size of internal audit. Such an analysis could, for example be organised as a spending review (see Reform 7.6). Countries such as Australia, Canada, the Netherlands and Spain, with relatively large internal audit capacity may use this analysis to reconsider their approach towards internal audit and realise substantial savings.

Reform 10.3. Limit the remit of Internal Audit to its core task: to support risk management

Characteristics of the reform

The core task of internal audit is supporting management by giving an opinion about risks of occurrences of errors, inefficient and uneconomic practices, or fraud. Some countries have assigned other tasks to IA units too, such as the task of certification of the annual Government's accounts, which SAIs are carrying out as well (Netherlands/Denmark). Other OECD countries such as France or Turkey, which traditionally have another control regime than other European and Anglo Saxon countries, have introduced internal audit in the public administration during the last decade but they are still carrying out financial inspection² tasks too, which influences the development of internal audit in these countries.

The reform consists of focusing internal audit on its core task: to support management in mitigating the risk of occurrences of errors, inefficient and uneconomic practices, or fraud.

Where did it occur?

Nearly all countries participating in the Value for Money study carry out compliance audit and performance audit in line with IIA or comparable standards. The internal audit units in the Netherlands, Denmark and Spain and to a certain degree in Austria and New Zealand provide certification of financial statements.

Analysis

Table 10.3 provides an overview of the scope of internal audit in the participating countries in the Value for Money study

Table 10.3. Scope of Internal audit

	Tasks of Internal Audit
Australia	Primarily compliance audit (support management to comply with obligations). Performance audits are accomplished at Chief Executive's discretion.
Austria	Compliance and performance audit in line with IIA standards. Joint certification of financial statements in area of international financial resources
Canada	Governance, risk management and control processes audit in line with IIA standards

Table 10.3. Scope of Internal audit (continued)

	Tasks of Internal Audit
Denmark	Audit of financial statements (certification) on behalf of SAI and additionally compliance and performance I audit.
Finland	Compliance and performance audit in line with IIA standards.
Netherlands	Audit of financial statements (certification) and performance (focus on risk management, control and governance processes).
New Zealand	Compliance and performance audit in line with IIA standards. Audit of financial statements at the discretion of the head of Organisation
Norway	Performance Audit.
Spain	Audit of financial statement (certification) and compliance audits.
Sweden	Compliance and performance audit.

Source: Responses to Value for Money questionnaire.

Canada is a good example of a country where the tasks are clearly defined in regulation, the so-called “Policy Internal Audit” (from Treasury Board). Box 10.4 presents the tasks of internal audit according to the Policy.

Box 10.4. Policy Internal Audit, April 2012

Policy Statement

Objective

The objective of this Policy is to contribute to the improvement of public sector management by ensuring a strong, credible, effective and sustainable internal audit function within departments as well as government-wide.

Expected Results

Deputy heads are effectively supported in their role of accounting officer by a strong, credible internal auditing regime that contributes directly to sound risk management, control and governance, and is independent from line management.

Deputy heads are provided with independent assurance from internal auditing, and advice from the audit committee, regarding the effectiveness of risk management, control and governance processes, at the departmental level and the Comptroller General is provided with the same at the government-wide level.

Source: Provided by the Treasury Board of Canada Secretariat.

This reform mostly concerns those countries participating in the study where the core task of IA is not supporting management in mitigating risk, but where the main focus of

IA is on certification of financial statements. These countries are Denmark, Netherlands and Spain.

Denmark and the Netherlands have an Anglo Saxon tradition of financial management and control and audit, but Spain represents the countries such as France and Turkey with a large emphasis on preliminary control of legality of transactions (*ex ante* control) and the financial inspection type of *ex post* control. Internal audit has been introduced in these countries during the last decade and is developing.

The specifics of these countries are dealt with in more detail below.

Denmark

Box 10.5. Internal audit in Denmark

In Denmark the Auditor General Act of 1991 (amended in 2006) regulates IA. Section 9.1 of the Auditor General Act (AGA) states that: “the Auditor General may arrange with the minister concerned that auditing the state accounts and accounts of institutions, associations, foundations, etc., whose expenses or accounting deficits are covered by grants financed by the state or by contributions, duties, or other revenues according to statute shall be performed in a specified defined co-operation between the Auditor General and an internal audit body”.

Thus the cornerstone of internal audit is the agreement entered into with the “Rigsrevisionen” (RR, the Danish SAI) under Section 9 of the Auditor General Act. In 2009 there were 28 agreements with several ministries including the ministries of Finance, Defence, Food, Taxation, Justice, and Transport. The organisation of the IA function is a reflection of the governance structure in the specific areas. The duties which internal auditors carry out and the part of the ministry covered by the audit differ from ministry to ministry. In some ministries internal audits are more focused, both in terms of the areas audited such as the Police department, Railway Infrastructure department and Danish Broadcasting Corporation.

After the agreement between the RR and the minister has been signed, the internal audit unit will carry out most of the financial audit work within a ministry (or of the agreed part of the ministry), with the RR overseeing the work, using findings of the internal auditor and carrying out an additional audit if needed. (This is a provision to ensure an effective co-ordination of the total audit work and to avoid double auditing activities). The internal auditors report to the head of ministry and top management of the ministerial department or agency and the RR. The RR retains overall responsibility for the performance of the audit and issues the audit opinion on the ministry as a whole.

Source: OECD (2011a).

In practice the internal audit units act as affiliates of the RR in Denmark. The RR determines when an internal audit unit is established, as well as the conditions under which the unit should work. In practice the RR is very cautious in establishing new internal audit units and not pro-active. Only when the RR is convinced that deficiencies in financial management (a weak accounting procedure for example) of a department or agency have been sufficiently been addressed, it will cooperate in setting up an IA function.

Currently the development of the internal audit function in Denmark goes in the opposite direction as in other OECD countries. In Denmark the internal audit units support the SAI by carrying out the certification of financial statements task. The establishment of internal audit units in ministries and agencies in other OECD countries is generally a decision of the executive branch and is based on its own legal regulation.

External audit institutions might have an advisory role but not a decisive role as in Denmark.

Netherlands

The internal audit function in the Netherlands was established in 1987. The Government Accounts Act defines three tasks for the internal audit departments of the state level:

1. Audits which certify the annual financial statements of ministries and agencies in terms of a “true and fair view”.
2. Performance audits (including compliance and information technology types of audits).
3. Audits of Third Parties, which receive and spend public funds.

The statutory task of certification of the annual financial statement of ministries and agencies is rather exceptional for internal audit. In most countries and also in the countries of the Value for Money Study internal audit concerns merely Performance Audits.

Since 1987 the tasks of internal audit have evolved as the financial management and control situation improved in the 1990s. The tasks were even extended. However, the large expansion of the internal audit units (50 in 1987 and 769 in 2010) in the 20th century has led also to discussions on how the quality (‘added value’) and the cost effectiveness of the internal audit services can be improved. The situation in the Netherlands has a historical background. Box 10.6 describes the subsequent development.

Box 10.6. Development of internal audit in the Netherlands

Until 1987, the function of internal audit on the state level was underdeveloped and never got real attention from the management of ministries. Then the Minister of Finance presented to the Parliament the “Plan Operation State Accounting system 1987- 1992” for improving the state accounting system. Improving the internal audit function was a part of this plan. Besides many other measures to improve the quality of internal audit, it was decided that internal audit units should add a ‘fair and true’ opinion to the annual accounts of each ministry. The new function of internal audit was laid down in a Government decree of 1987, which was amended in 1995. The task of the internal audit departments was then extended with auditing non-financial management and the internal audit departments should also give an opinion on the annual accounts of the newly established agencies.

A spending review in 2001 (“Kordes Commission”) recommended to broaden the scope of the internal audit departments and to expand the task of the internal audit departments with periodical audits of policies and management. The expansion of the tasks of the internal audit departments implied that the internal audit function was transformed into a multidisciplinary audit function. The working group also recommended to centralise specialism’s (‘create pools’), and to initiate inter-ministerial personnel policy. An evaluation of the implementation of the recommendations of the Kordes Commission in 2003 was clear: the internal audit departments were restructured, but the transition of the work was incomplete. The statutory task required a minimum capacity of the audit service. Another spending review led in 2004 to the conclusion that the balance between efficiency and regularity in internal audit had swung too much to regularity. There were too many complex rules and too little differentiation in types of audits. Overlaps in the control system were abolished, ministers became responsible for regularity and the role of the audit units became more transparent. But the nature and the scale of the audit work did not change.

Box 10.6. Development of internal audit in the Netherlands
(continued)

In 2008 the “Memorandum Central Government Reform” concluded that concentration of support services could lead to a reduction of audit cost. It was also decided that the audit activities of four ministries, which volunteered, as an experiment should be concentrated in one service in order to improve the audit quality. The evaluation of this experiment was clear: concentration will be further continued but abolishing the statutory task was not on the agenda.

Source: OECD (2011b).

The description in Box 10.6 of the development of the internal audit in the Netherlands since 1987 shows that the tasks of internal audit have evolved. However, it is striking that the question whether this balance could better be achieved by excluding the certification of financial statements from the statutory tasks of the internal audit units and to let them focus on supporting management in mitigating the risks of occurrences of errors, inefficient and uneconomic practices, or fraud has never deeply been discussed. The question whether internal audit units should annually certify the accounts of a ministry or agency has been discussed in spending reviews of 2001 and 2004 (see Box 10.6), but has not led to a fundamental change.

In international practice certifying the annual financial statement of the state and in many cases of local governments is recognised as the core task of the external audit function, the SAI, and is regulated by INTOSAI.³

The efforts since 2001 to improve the quality of internal audit have been hindered by the capacity need for the statutory certification task. It can also be argued that the advisory task of the internal auditor concerning risk mitigation (the result of the various types of audit activity) and the annual certification task are leading to a conflict of interest. Centralising the IA activities in the Ministry of Finance does not solve this problem, but even creates a new problem: in the long run the internal auditors could be regarded as representatives of the Ministry of Finance and serving the interests of this ministry (‘watchdog of Finance’) and not the interests of the line ministry they are auditing. Indeed, according to the international principles, internal audit is a tool of management and the internal auditor is a part of the organisation he/she audits with sufficiently guarantees independence.

Transferring the statutory certification task to the Court of Audit might seem a radical policy change, but in international perspective the Netherlands (with Denmark and Spain) stands alone and its vision on internal audit is an exception rather than the rule. Transferring the statutory task will not only lead to a clear division of task between internal and external audit but will also lead to savings. Indeed, the Court of Audit reviews yearly the statutory audit work of the internal auditor. One third of the Court’s audit capacity is reserved for this activity. On an annual basis a substantial saving could be realised by abolishing the certification task of IA.

Spain

The General Comptroller of the State Administration (IGAE) is the internal control organ of the economic and financial management of the Government. It is in charge of verifying, by means of preliminary control of legality and ongoing financial control, that the economic and financial activity of the Government observes the principles of legality, economy, efficiency and efficacy as the managing and executive centre of the

government accounts it is responsible for providing reliable, comprehensive, professional and independent information on public management and for issuing the necessary procedures for its proper development.

Besides this control task the IGAE carries out audit tasks: audit of annual financial statements (certification), compliance audits, and all types of performance audits (such as audit of budgetary programmes, audit of programme contracts, audit of state tax accounts, audits of privatisations) (EC, 2012). The IGAE is the only institution that performs IA (at the federal level) and has 180 staff at its disposal for the audit tasks.

As the certification of the annual Government's financial statements may take substantial resources the IGAE may consider to leave this task to the Spanish SAI, the *Tribunal de Cuentas*, for the same reasons described for the Netherlands. The development of internal audit in Spain could highly benefit from such a decision and substantial savings could be realised.

Feasibility of the reform

This reform has a long-term perspective. It will require amendments to the legal framework of the three countries concerned. But before amending laws or regulations a thorough analysis and debate between Governments and SAIs of the three countries about the results of this analysis will be needed.

Notes

1. Uneconomic means wasteful or extravagant. It means not getting the right amount of resources, of the right quality, delivered at the right time and place, at the lowest cost. (INTOSAI, 2004)
2. Financial Inspection is an *expost* control activity, which aims to detect irregularities, punish perpetrators and recover damages to the public sector organisation;
3. The reason that internal auditors in the Netherlands still annually certify the ministerial financial statements is related to how the Dutch Court of Audit perceives the ministerial accountability concept. The Dutch Court of Audit is of the opinion that the minister is accountable for the reliability of the accounts and a sound financial management and control and that the annual internal audit report “serves the minister in deciding whether the financial accounts under his supervision can be released” (Baayens, van der Wielen, 2009). In this view the Court of Audit is not a part of the executive branch and can therefore not function as the certifying body for government institutions.

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Chapter 11

The machinery of government

This chapter focuses on one group of organisations of which the central government is composed, namely the core ministries (as opposed to the agencies). This chapter deals with the way in which the central government is structured into ministries and with the size of the cabinet; the number of deputy ministers and other political officials; the number of political advisors and the number of cabinet committees.

In view the diverse structures of the machinery of government across the participating countries, this chapter establishes a terminology that is internationally applicable.

This chapter presents four reforms that all lead to a simplification of the machinery of government in the sense of less ministers; smaller cabinets; less deputy ministers and other political officials; less political advisors; and less cabinet committees. This does not only lead to savings on the operational costs associated with these officials and bodies, but also on the size of ministerial expenditures more generally (including programme expenditures). This chapter provides extensive empirical evidence on the likely savings that can be realised by simplification in this sense.

Introduction

The organisation and co-ordination of the machinery of government

The topic of this chapter is the way in which the machinery of government is organised and co-ordinated across the countries participating in the study, and how it might be improved and made more efficient. The term “machinery of government” refers to the way in which the central government is structured into various departments (Machinery of Government Committee, 1918). This chapter deals with reforms relating to the size of the cabinet, the number of deputy ministers and other political officials, as well as the use of political advisers to ministers. It also considers a related reform of decision-making structures in cabinets, in particular cabinet committees.

Cross-national patterns

This chapter highlights the large amount of variation with regard to the organisational features outlined above. One discernible pattern is that, on average, Westminster-style democracies tend to have more complex and elaborate executive structures than the other countries covered by this survey. At the time of data collection (2009-2010), Australia, Canada and New Zealand had the largest number of ministers. Unlike most survey countries, they also make a distinction between different levels of seniority that relates to whether members have full cabinet rank – and thus participate in all major collective decisions taken in the executive – or are more junior and without full membership of the cabinet. The size of cabinet is positively correlated with the number of cabinet committees. The three Westminster countries for which survey data are available are also amongst those where cabinets operate complex committee structures, sometimes involving a substantial degree of decision-making authority delegated to subsets of ministers. However, the association between cabinet size and cabinet committees is not deterministic. For instance, Spain has one of the smaller cabinets among the countries surveyed, but nonetheless maintains several cabinet committees. The Westminster democracies tend to stand out in other aspects as well, such as the comparatively extensive use of political advisers in government departments. However, there are not always obvious clusters of countries. For instance, the degree to which governments rely on political advisers varies across the Nordic countries, from extremely limited (Denmark) to more extensive (Sweden).

Terminology

One of the difficulties with assessing executive organisation is that the terminology used across different countries does not always lend itself to straightforward comparison. To facilitate comparison, this chapter introduces a set of key terms, which are contained in Box 11.1 for easy reference. Any comparative remarks and observations in this chapter, unless indicated otherwise, are based on these definitions (as well as the definitions in the glossary that are applicable throughout the study).

The findings and discussion in this chapter highlight that some countries are able to run governments with a small number of ministers, and without a significant number of deputy ministers and political officials. There is substantial empirical evidence that the number of politicians in government has a sizable effect on total spending and deficits, which suggests that this is an area for reform where substantial savings could be obtained in several countries. In addition, smaller cabinets are also likely to be less reliant on complex committee structures in order to ensure their functionality. The study also notes

that there is scope to greatly contain or abolish political advisers in government in a number of the survey countries.

Reform recommendations

In sum, the core reform recommendations in this chapter are as follows:

- Contain the number of ministers, ideally to no more than 15.
- Minimise the number of deputy ministers and other political officials.
- Strictly limit the number of political advisers to ministers.
- Simplify cabinet committee structures.

Box 11.1. Key terminology used in this chapter

Cabinet: A group of Ministers that constitutes the highest body of collective decision-making in the Executive branch of Government.

Cabinet committee: A subgroup of Ministers who can take collective decisions that are binding across Government or prepare proposals for approval by the full Cabinet. Cabinet committees reduce the burden on Cabinet by enabling collective decisions to be taken by a smaller group of Ministers.

Civil servant: A public employee whose contract is based on public law and who cannot be recruited, promoted, demoted or dismissed on political grounds.

Deputy Minister: A politician who does not head a ministry (portfolio) and is not a member of the Cabinet, but who is accountable to Parliament for a policy area. Deputy Ministers are subordinate to a Minister and assist in the execution of a particular part of the Minister's duties.

Minister: A politician who heads a ministry or portfolio and is accountable to Parliament for a policy area. In many countries, Ministers are typically members of the Cabinet, but others make a distinction between Ministers with and without Cabinet rank.

Minister without portfolio: A politician who does not head a ministry (portfolio), but who has Cabinet rank and is accountable to Parliament for a policy area.

Political adviser: An individual appointed by a Minister for the period that the Minister is in office, who is not a Minister or Deputy Minister, and who is not entitled to give instructions to regular civil servants. Political advisers are employed to advise and support Ministers on political and strategic matters where it would be considered inappropriate for regular civil servants to become involved.

Political official: An official who is appointed by a Minister, the Cabinet or Chief Executive for the period that a Minister is in office, and who is entitled to give instructions to regular civil servants. Unlike Ministers and Deputy Ministers, political officials are not accountable to Parliament.

Reform 11.1. Contain the number of ministers

Characteristics of the reform

The reform consists in the limitation of the number of ministers to no more than fifteen. There is robust empirical evidence from several studies that a large cabinet is costly in fiscal terms. Despite differences in samples and statistical techniques, the

available estimates are remarkably similar and suggest that a reduction in the number of ministers by one reduces the deficit in a given year by about one tenth of a per cent of GDP. The econometric estimates suggest that a reduction from the current average of 19 to the benchmark number of 15 would produce immediate savings worth approximately half a percentage point of GDP.

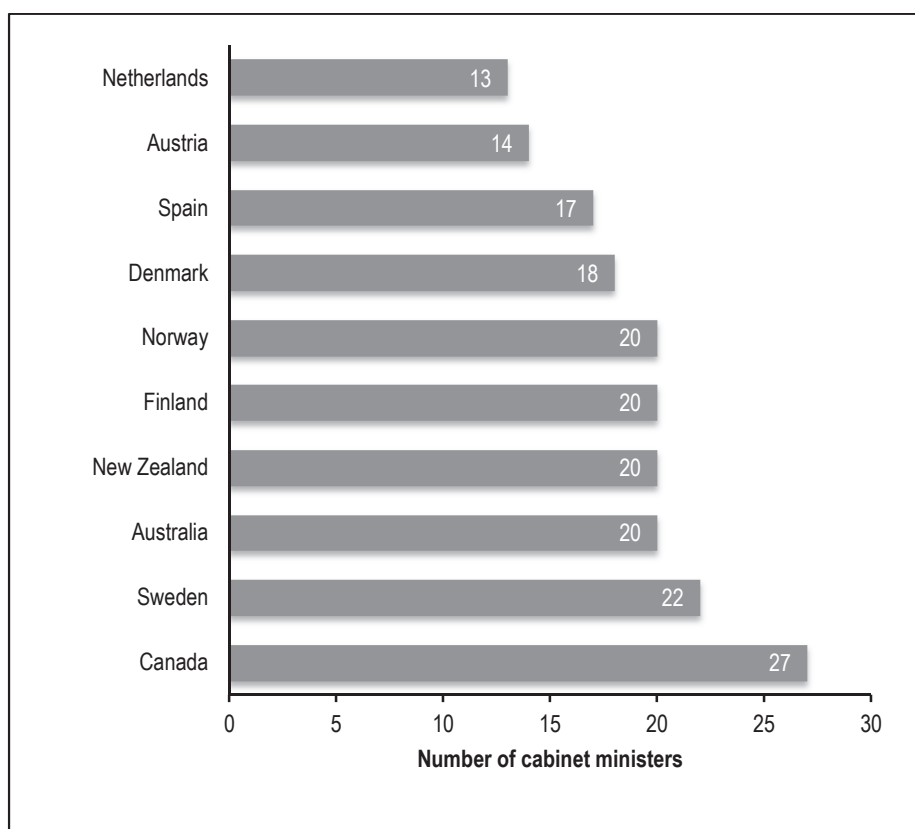
Where did it occur?

The survey results show that, at present, only two countries out of 10 meet the reform target recommended in this chapter. At the time of the survey, the cabinets of Austria and the Netherlands comprised 14 and 13 ministers, respectively. The cabinets of Spain and Denmark also come close to the benchmark. Although the survey did not cover the evolution of cabinet size over time, other studies show that the number of ministers within the same country has varied greatly over past decades (Wehner, 2010). Many cabinets were substantially more compact in the past than they are at present. This suggests that, in principle, a reduction in cabinet size is not impossible to implement across a wide range of countries.

Analysis

The number of cabinet portfolios grew rapidly in many OECD countries after the end of World War II, partly reflecting the need for reconstruction as well as the expansion of state activities. This trend broadly continued until the 1980s, when patterns became more varied (Pilichowski, 2004). The determinants of the number of ministers are diverse. In federal or strongly decentralised countries, certain expenditure functions may be assigned to the sub-central level and require little or no central government involvement. Some cabinet positions reflect geographical features or the importance of a country's hydrocarbon or mineral wealth, such as ministers responsible for regulating the extraction of natural resources. Governments also create ministers to signal their political priorities and their responsiveness to changing needs in society.¹ In member countries of the European Union (EU), regular meetings often require ministerial representation for particular policy areas, which may limit the potential for merging or reducing portfolios (Bekker, 2009). Finally, cabinet positions are also used to reward political allies and to accommodate rivals, which may at times necessitate the creation of a new portfolio (Dunleavy and White, 2010).

Figure 11.1 summarises the number of ministers for the survey countries. To ensure comparability, the focus is on ministers who have cabinet-level rank. The median number of total cabinet-level ministers is 20, but there is large variation. Canada has by far the largest number of ministers with cabinet rank, a total of 28² which is more than twice the number in the Netherlands (13). Most countries cluster around the sample median of 20 ministers. Several study countries (Australia, Canada and New Zealand) make a distinction between outside the cabinet and those who have full cabinet rank and participate fully in decisions. It is striking that Westminster-type systems typically use differential ministerial ranks. The distinction between ministers with and without cabinet rank is one way to ensure that a government consisting of a large number of ministers can function effectively. In Australia, for instance, Prime Minister Robert Menzies in 1956 decided to split ministers into two groups, a cabinet of 12 and ten others outside the cabinet, following a steady expansion in the number of ministers from just nine at the beginning of the century (Weller, 1980). Ministerial hierarchy was introduced to help ensure that the size of the cabinet remains at a level that it is conducive to efficient decision-making.

Figure 11.1. The number of ministers with full cabinet rank

Source: Responses to the Value for Money questionnaire.

In Sweden, all ministers have cabinet rank, but 9 are ministers with specific responsibilities within a ministry (e.g. the Minister for Social Security works in the Ministry for Health and Social Affairs), which is headed by the Minister for Health and Social Affairs. The total for Sweden (22) includes these 9 ministers. Ministers outside the cabinet in Australia (10) and New Zealand (3) are excluded. Also excluded are various deputy ministers (as defined in Box 11.1), such as Ministers of State in Canada (currently 13) and State Secretaries in the Netherlands (5). The following reform (11.2) discusses deputy ministers in more detail.

The number of ministers has a substantial and well-documented effect on fiscal performance. The political economy literature highlights problems that arise when expenditure can be targeted at a particular constituency while costs are shared equally across all taxpayers (Von Hagen and Harden, 1995, Velasco, 2000). Building on this insight, a number of studies investigated the fiscal effect of cabinet size or the number of spending ministers, whose “constituencies” are most likely to benefit from targeted programmes (Alesina and Perotti, 1996). For example, a transport minister may advocate large-scale infrastructure projects that benefit construction companies and their employees, and particular users of such infrastructure, knowing that the costs of such projects are shared widely across all taxpayers. Volkerink and De Haan (2001) studied 22 OECD countries from 1971 to 1996 and found that the addition of one spending minister leads to a deterioration of the central government budget balance by 0.08 per cent of GDP. Perotti and Kontopoulos (2002) used a panel of 19 OECD countries between 1970

and 1995 and estimate that an additional minister increases the general government deficit by 0.12 percentage points of potential GDP per year, due to impacts on spending. Ricciuti (2004) uses data for 19 OECD countries from 1975 to 1995 and estimated that an additional minister decreases primary surplus by -0.13% and adds 0.11% to primary spending. Studies with larger samples including non-OECD countries come to remarkably similar conclusions (Woo, 2003; Wehner, 2010). In sum, there is strong evidence that an increase in cabinet size or the number of spending ministers is associated with less fiscal discipline.

Another reason for containing the size of cabinet is that an excessively large body is unlikely to function effectively. The historian Cyril Northcote Parkinson studied a number of examples from British history as well as comparative data and observed that cabinet decision-making ceases to be effective when the number of members exceeds 20 or 21 (Parkinson, 1957). Klimek et al. (2009) used this observation as the basis for an empirical investigation of the link between several indicators of government performance and the number of ministers in the cabinet. Using cross-sectional data for 197 countries and self-governing territories, they find that cabinet size is strongly and negatively correlated with several indicators of government performance. The authors go on to develop a model of opinion dynamics in groups that links group size to the possibility of dissensus and accounts for their empirical results. This work supports the view that large cabinets are particularly challenged to develop effective decision-making procedures. In addition, the final reform of this chapter (11.4) suggests that some additional costs arise from the tendency to maintain and service complex committee structures in large cabinets.

Cross-national differences in the number of ministers appear not to be driven primarily by legal constraints (see Table 11.1.). In seven of the countries studied, ministers are appointed *de facto* by executive decision, which gives the government a substantial degree of autonomy. Two countries regulate the number of ministers in a law. In Austria, article 77(2) of the constitution requires a law to fix the number of federal ministries, their area of competence and their internal organisation. As a result, changes to the mandates or number of ministries entail amending the Law on Federal Ministries (*Bundesministeriengesetz*). In Canada, the Salaries Act provides for the salary of the Prime Minister, 25 ministerial positions required by departmental legislation and of 9 discretionary ministerial positions. However, the Ministries and Ministers of State Act sets no limit on the number of Ministers of State, who are junior ministers often without cabinet rank. The only country studied with constitutional limitations is Norway, where article 12 of the constitution requires the King to appoint the Prime Minister and at least seven other members to the Council of State, or cabinet. However, the constitution does not define an upper limit. In general, legal frameworks tend to give the executive at least some flexibility to adjust the number of ministers.

In practice, the number of ministers typically changes when shifts in political priorities lead to a reconfiguration of existing portfolios or the creation of entirely new portfolios. In line with previous studies (Davis et al., 1999), the survey results confirm that most governments (7 out of 10) adjust the number of ministers with the formation of a new cabinet following an election. Canada and the Netherlands report that such changes are less frequent. Spain is the only country to report that the number of ministers is adjusted not only with the formation of a new government, but also in between elections. Such reorganisations can help governments to adapt to new circumstances and strategic goals, and they offer an opportunity to reward allies or side-line adversaries. However, the creation, abolition or amalgamation of entire departments is also costly, which

suggests a need to balance flexibility with cost considerations based on careful analysis (National Audit Office, 2010).³

Table 11.1. The legal basis for the number of ministers

Legal basis	Executive decision	Law	Constitution
Countries	Australia (a) Denmark (b) Finland Netherlands (c) New Zealand Spain (d) Sweden	Austria (e) Canada (f)	Norway (g)
Total number	7	2	1

Notes:

(a) Administrative Arrangements Order.

(b) According to section 13 of the Constitution, the King decides the number of ministers.

(c) Coalition agreement and royal decree.

(d) The Prime Minister decides by decree.

(e) Regulated in the *Bundesministerienengesetz* (law on federal ministries).

(f) Thirty-four positions (in addition to the Prime Minister) are listed in the Salaries Act, of which 25 must be filled and 9 are discretionary. The Ministries and Ministers of State Act does not establish a limit on the number of Ministers of State.

(g) Article 12 of the Constitution requires the King to appoint the Council of State consisting of a Prime Minister and at least 7 other members, without an upper limit.

Source: Responses to the Value for Money questionnaire.

In many countries the head of state has a formal role in appointing ministers. However, the actual process is inherently political and reflects delicate strategic considerations, in particular in countries where coalition governments are common, such as Denmark, Finland and the Netherlands. This applies also to New Zealand since a reform of the electoral system in 1996, which made it more difficult for a single party to gain a majority of seats in legislative elections. In Norway, the Prime Minister enjoys substantial discretion when heading a single-party government. In this case, the Prime Minister would typically consult senior members of his party, although over the past decades party influence seems to have declined. In contrast, during times of coalition government, the final selection of ministers is negotiated between the Prime Minister and the leaders of other parties in the governing coalition. A similar distinction applies in Sweden, where governments in recent decades have included both single-party and coalition arrangements.

Under conditions of single-party government, chief executives may not have to accommodate and balance coalition partners, but intra-party dynamics or other political factors can nonetheless impose significant constraints. In Australia, the Prime Minister *de facto* decides on ministerial appointments, but exercises this power within the context of particular partisan traditions. In the Australian Labour Party, ministers have customarily been appointed on the advice of the Caucus (a body comprising all Labour Members of Parliament), whereas a Liberal leader is able to choose ministers more freely from within the parliamentary party. Moreover, appointments have to balance representation from the elected Senate and the House of Representatives, as well different intra-party factions

(Weller, 1980). In Canada, cabinets typically include ministers from each of the provinces and have to carefully balance Francophone and Anglophone representation, among others. Even for single-party governments, therefore, certain traditions and country-specific considerations can limit a chief executive's choice of ministerial assignments.

Ministers with full cabinet rank typically represent a single government ministry, but this need not be the case. The practice in New Zealand stands out in this regard. Here, the same minister can be appointed to lead a number of different ministries. At the time of the survey, New Zealand had 20 ministers with cabinet rank, who collectively held 47 portfolios. These assignments are not always obviously related, as in the case of a minister responsible for both the fisheries as well as the housing portfolio. Where a single minister is responsible for related ministries, this could be considered an example of what Mackie and Hogwood (1984) refer to as “internalised” co-ordination. They observe that this practice is more common in small countries, but equally it could be a first step towards re-consolidating overly fragmented ministerial structures.

In EU member countries, the process of integration has affected ministerial workloads in certain cases (Bekker, 2009). New tasks have emerged in particular for ministries dealing with agriculture, finance, foreign affairs and justice, and in general EU affairs have become important across ministries. However, in several member countries, this has not affected the overall number of ministers. In Austria, EU-relevant business has been integrated into the Ministry of European and International Affairs, the Chancellery and the Ministry of Finance, and some ministries have specialised divisions. In Denmark, the Ministry of Finance manages economic relations and the Ministry of Foreign Affairs diplomatic and political relations. Similarly, European integration has not affected the number of ministers and ministries in Spain, where EU-related responsibilities have been either incorporated into existing units or assigned to new units within an existing ministry.

In response to the demands of European integration, several countries have created executive positions with co-ordinating functions in EU-related matters. In Finland, the creation of political State Secretaries was partly justified by the country's membership in the EU (see Box 11.4 under Reform 11.2). The Finnish Government also includes a minister responsible for European affairs, usually as part of a broader portfolio. At the time of the survey, this was the Minister of Migration and European Affairs. In the Netherlands, the State Secretary for European Affairs has a co-ordinating function, which allows the Foreign Office to work with relevant ministries as required. Within the Foreign Office, the Directorate for European Integration provides support and seconds staff to the Prime Minister's Office and elsewhere in the Government. In Sweden, responsibility for EU affairs was transferred from the Ministry for Foreign Affairs to the Prime Minister's Office and a new post of Minister for EU Affairs was created.

Some cabinets also include ministers without portfolio, who do not head a ministry of their own. Such positions can be particularly useful in coalition governments, to balance the assignment of portfolios across the different political parties around the cabinet table, or to dispense patronage. Five of the survey countries supplied information on their use of ministers without portfolio. Out of these, only two countries – Canada and the Netherlands – reported that such positions are currently in use. Australia reported that such ministers do not exist, while Denmark and Sweden responded that ministers without portfolio were part of previous governments but did not exist at the time of the survey.

In the Netherlands, cabinets generally include ministers with a high-profile task but without their own portfolio. They are housed in an existing ministry and equipped with

necessary support and budgets. Their position is regarded as slightly less powerful than those of other cabinet members and they are arguably more reliant on political support from Members of Parliament and relevant interest groups. A long-standing example is the Minister for Development Co-operation, housed in the Ministry of Foreign Affairs. In addition, two “programme ministers” were created in 2007. One of these was the Minister for Youth and Family – who was also Deputy Prime Minister – with responsibility for youth, children and family affairs. His office was located in the Ministry of Health, Welfare and Sport, and he also received support from civil servants of other departments. His budgetary responsibility included child benefits and the youth care budget.

In Canada, the designation of “minister without portfolio” was used in the past but has been rare in recent decades. Instead, Ministers of State do not have statutory responsibilities and may be appointed to assist other ministers with their responsibilities. They receive resources for office support, including staff. Ministers of State may also be appointed where it is considered necessary for the purposes of formulating and developing new and comprehensive policies in relation to specific responsibilities of the Government.

Feasibility of the reform

Given that some survey countries already meet the required standard, and others come close to it, it is clearly possible to run governments with fewer ministers – and to govern effectively at the same time. Moreover, constitutional provisions that constrain cabinet size are rare, and in most countries the legal obstacles to reducing the number of ministers are minimal or non-existent. On the other hand, political constraints and considerations may pose a greater obstacle in implementing this reform, in particular for coalition governments. Possibly, these obstacles are easier to overcome in times of fiscal consolidation. Faced with large-scale cutbacks in public services, it is difficult to justify to the public the continued existence of over-sized cabinets.

Reform 11.2. Minimise the number of deputy ministers and other political officials

Characteristics of the reform

The reform consists of reduction of the number of deputy ministers and other political officials. The evidence on the number of politicians in ministerial structures, too, highlights the wide variety of practices across OECD countries. Some countries, such as Denmark, manage to run governments without any deputy ministers at all, while others, such as Canada, use complex hierarchies of ministerial appointments. There is no evidence that governments with fewer deputy ministers function any worse than those with a large number of such positions. On the contrary, there is concern that an excessive number of deputy ministers and political officials may even harm the effectiveness of government. Governments keen to achieve greater economies should minimise the number of deputy ministers.

Where did it occur?

Country-level terminology is particularly varied when it comes to positions that this study defines as deputy ministers (see Box 11.1). In order to avoid misunderstandings, it is helpful to provide additional background on national terminology. Labels for ministerial deputies in the Anglophone countries include Parliamentary Secretaries (Australia, Canada), Ministers of State (Canada) and Associate Ministers (New Zealand).

Note that in Canada, the title “Deputy Minister” is used for the senior civil servant in a department, equivalent to a Permanent Secretary in the UK or Departmental Secretary in Australia, and does not fall under the definition of deputy minister used here. In the other countries studied, official titles for ministerial deputies include State Secretaries (Austria, Netherlands, Norway, Sweden) and Secretaries of State (Spain). Unlike in Spain, some governments use the title of “Secretary of State” to designate high-level ministers with full cabinet rank, for instance in the UK and the US. All of these country-specific labels have to be carefully interpreted when comparing ministerial ranks across different systems (Wehner, 2010).

Eight out of ten countries reported that they have deputy ministers as defined for the purpose of this study, with Denmark and Finland as the exceptions. In Austria, the number of deputy ministers is flexible but in practice their use is not extensive; at the time of the survey, there were only four State Secretaries. In several countries, most portfolios have one or two deputy ministers (Australia, Norway, Sweden). In these countries in particular, there is scope to reduce the number of ministerial deputies (see also Box 11.2).

Analysis

Box 11.2. Too many ministers in the UK

In 2010, the Public Administration Select Committee of the UK House of Commons published a hard-hitting report in which it investigated the number of ministers, including junior ministers and various political appointees. It found that, between 1900 and 2010, the number of cabinet-level ministers increased modestly, from 19 to 23. In contrast, the number of ministers without cabinet rank – using a broad definition that includes various other ministers, law officers (chief legal advisers) and whips – more than doubled from 41 to 96. Hence, the overall increase in the number of ministers from 60 to 119 is mainly due to the growing number of ministers without cabinet rank. It is worth noting that this total excludes other political appointees that add to the so-called “payroll vote”, such as Parliamentary Private Secretaries, who every Cabinet Minister and Minister of State is entitled to appoint subject to the approval of the Prime Minister. Their number has been around 45 in recent years. The report of the Committee is particularly damning with regard to the role of ministers without cabinet rank. One of these junior ministers characterised his existence as “almost entirely pointless”. A civil servant complained: “The more junior ministers you have... the more work you have to find for them”, and went on to describe this as “one of the biggest single frustrations about the political process within the civil service”. The Committee worried that an excessive number of ministers “harms the effectiveness of government” and recommended cutting the number of ministers “possibly by as much as one third”.

Source: House of Commons of the UK (2010).

The degree to which deputy ministers can act as substitutes for the main minister is often limited formally and/or in practice, but the form of such restrictions varies significantly across – and sometimes within – different countries. Swedish State Secretaries cannot replace their Minister at Cabinet meetings, but often act as a substitute at other occasions, such as meetings of the EU’s Council of Ministers. New Zealand’s Associate Ministers are unusual, because they typically at the same time have other portfolios, which give them full rights to participate in Cabinet. To what extent they can use their role as Associate Minister to speak on behalf of the main minister is carefully regulated in the Cabinet Manual (see Box 11.3). In Norway, there is no fixed and clear-

cut role for State Secretaries, so that the minister for whom they work has substantial autonomy to define their tasks and functions. In practice, State Secretaries do not usually deputise for ministers at cabinet meetings. When a minister is absent, another minister is normally appointed as substitute. Norwegian State Secretaries also do not take part in parliamentary sessions. In contrast, one of the roles of State Secretaries in Austria is to represent ministers in Parliament. Canadian Parliamentary Secretaries also assist ministers with parliamentary business. These positions provide career progression opportunities for professional politicians.

Some countries have different types of political appointments to support portfolio ministers. In Canada, Ministers of State can be appointed by the Prime Minister to assist other Ministers with their portfolio responsibilities on particular files (e.g. representing their Minister or the government at events, meeting with stakeholders, demonstrating policy leadership on one or more specific initiatives related to their assignments at the direction of the Minister). In certain instances, the Prime Minister may also appoint a Minister to take on additional duties in the portfolio of another Minister. In such cases, as in the case of Ministers of State, the portfolio Minister is accountable for the entire portfolio. There is no limit to the number of Ministers of State that can be appointed. Ministers of State are not necessarily members of the Cabinet. In addition, Parliamentary Secretaries are appointed under the Parliament of Canada Act to assist the Minister with his or her parliamentary duties, including participation in parliamentary committee meetings and liaising with caucus members. There can be as many Parliamentary Secretaries as there are positions set out in the Salaries Act. Parliamentary Secretaries do not have ministerial status and they are not members of the Cabinet.

Deputy ministers can also serve less codified but no less important monitoring functions in the context of coalition government. Thies (2001) highlights that governments rely on delegating authority to individual ministers, giving rise to principal-agent problems. Such problems are likely to be less pronounced under single-party governments, but potentially severe under ideologically fragmented cabinets. Thies (2001) demonstrates that deputy ministers in coalition governments can be strategically assigned so that they “keep tabs” on ministers from different political parties, to ensure that they stick to any deals agreed to in the coalition agreement. This role is important in the Netherlands, where State Secretaries as a rule come from a different political party than the minister. In Norway, too, coalition governments usually have State Secretaries from different coalition parties in the Prime Minister's Office and certain politically important ministries. However, this practice is not universal. In Sweden, for instance, arrangements that combine Ministers and State Secretaries from different parties are very rare, with the exception of the Political Co-ordination Secretariat in the Prime Minister's Office, which consists of a State Secretary from each of the parties in a coalition government. One reason for such differences might be that other institutional arrangements can play a similar monitoring role in coalition governments (e.g. Martin and Vanberg, 2004).

Box 11.3. Associate Ministers in New Zealand

The Prime Minister may, by letter, assign responsibilities to Associate Ministers. Associate Ministers assist portfolio Ministers to carry out tasks relating to their portfolios. Any statutory powers or functions that they exercise on behalf of the portfolio Minister are exercised under the authority of Section 7 of the Constitution Act 1986. In most cases, Associate Ministers have other ministerial portfolios in their own right. They are bound by the principle of collective responsibility, whether inside or outside Cabinet

The control of a portfolio always rests with the “portfolio” or “principal” Minister. When an Associate Minister is appointed to support a portfolio Minister, the principal Minister must provide a formal letter clearly setting out the role of the Associate Minister in the portfolio, any delegated responsibilities, and relevant working arrangements. The Prime Minister, through the Secretary of the Cabinet, must be consulted on each letter before it is finalised. Once the letter has been finalised, the portfolio Minister provides copies to the Secretary of the Cabinet and to the chief executive of the department or departments concerned.

Delegations to Associate Ministers are set out in a schedule of delegations compiled by the Cabinet Office. The schedule is presented to the House of Representatives to clarify accountability (so that, for example, parliamentary questions can be directed to the appropriate Ministers for answer). The schedule is also publicly available (New Zealand Government, 2008).

Associate Ministers should take particular care to avoid making public statements or taking initiatives of any sort without the knowledge and approval of their portfolio Minister. The delegation letter generally sets the parameters of the Associate Minister's communication with departments. Associate Ministers should ensure that those parameters are respected.

Associate Ministers may submit papers to Cabinet committees or Cabinet within their designated area of responsibility, provided that the paper clearly indicates that the portfolio Minister agrees with the submission of the paper.

Associate Ministers who are not already members of a Cabinet committee in their own right may attend the committee to take through a paper submitted by the appropriate portfolio Minister, with the approval of that Minister and the committee chair. If a committee is considering an item that is relevant to an Associate Minister's own responsibilities, the Associate Minister will receive the relevant papers and may attend the meeting.

Source: Extract from New Zealand Government (2008), paragraphs 2.33-2.38.

The survey also explored the use of other political officials, which in some countries are subject to ongoing debates. This term refers to officials whose appointment is tied to a particular minister's term in office, who are entitled to give instructions to regular civil servants but who are not accountable to Parliament (see Box 11.1). The distinction between deputy ministers and other political officials is often blurred. During the debate preceding the introduction of political State Secretaries in Finland, some argued in favour of deputy ministers who are subject to parliamentary accountability. Box 11.4 highlights some of the contesting arguments advanced in the run-up to the decision. On the one hand, many politicians felt a need to enhance their steering capabilities in the face of demanding workloads. Opponents of the reform feared that it would weaken accountability and expose the professional civil service to political interference that could undermine its ethos.

Box 11.4. Political State Secretaries in Finland

In December 2004, the Finnish Parliament approved legislative changes that enable ministries to establish posts for political State Secretaries. Previously, State Secretaries had always been non-political civil servants, with the sole exception of the Prime Minister's Office where the State Secretary has been a political figure since the early 1990s. At the time of the survey, there were 12 ministries in the Finnish state administration, some of which had more than one minister. Two ministers in the same ministry usually are from different political parties in the governing coalition, and they share the responsibilities of the ministry between them. Political State Secretaries are connected to ministers, so if there are two ministers in one ministry both of them can have their own Political State Secretaries. In 2005, the Government appointed nine State Secretaries, which later increased to ten.

The change in the legislation was preceded by a lengthy discussion on leadership in ministries. An important motivation for the reform was a perception that civil servants had acquired too much power. Some politicians felt that the public management reforms of the 1980s and 1990s had diminished their power to steer the administration and that influence had shifted to top civil servants. The legislative changes aimed to strengthen political steering capability in relation to professional civil servants. At the same time, the reform was also seen as a way to avoid the politicisation of high-ranking civil servant positions. Another argument was that the workload and duties of ministers had grown with the Finnish membership to the European Union.

As there is a civil servant (non-political) State Secretary in each ministry (except in the Prime Minister's Office, where there is only a political State Secretary and civil servant Undersecretaries of State), the discussion in the run-up to the reform focused on the relationship and division of tasks between the existing civil servant State Secretary and the new political State Secretary. Another issue that dominated the discussion was the parliamentary responsibility of the latter. Views were expressed that instead of political State Secretaries, Finland should establish new posts of junior ministers. The supporters of this view emphasised that this would better ensure accountability to Parliament. It was agreed that the political State Secretary is not the highest civil servant in a ministry and the civil servant State Secretary is not under the authority of the political one. An attempt was made to specify the roles and duties so that a civil servant State Secretary concentrates on the effective functioning of the ministry and the political State Secretary serves as the minister's closest adviser. The duties of existing civil servant State Secretaries were not transferred to the new political posts.

The tasks of political State Secretaries include advancing and monitoring the relevant part of the Government programme, supporting the minister in steering preparatory work in the ministry, and ensuring co-ordination with other parts of the government (together with the civil servant State Secretary). They also assist the minister with international and EU-related responsibilities, represent the minister when required, and exercise other delegated functions. The political State Secretary can represent the minister when required, for example in ministerial working groups (except for those based on legislation that require the minister to take part), or international meetings and visits. However, they cannot represent ministers in cabinet meetings, plenary sessions of the Parliament, or when the minister answers parliamentary questions. The relationship between a minister and a political State Secretary is one of trust, as the latter represents the minister's views. A minister is politically accountable for the work of a political State Secretary under her authority.

Source: Response to Value for Money questionnaire.

Feasibility of the reform

The feasibility considerations in this reform area are very similar to those discussed above in relation to the number of ministers. In some countries, the political obstacles to reform could be formidable, as low-level ministerial appointments and appointments of other political officials have been used to dispense patronage and to buy acquiescence. However, public sentiment should be strongly in favour of such reforms, in particular in times of fiscal austerity.

Reform 11.3. Strictly limit the number of political advisers to ministers

Characteristics of the reform

Political advisers are controversial in many countries. Public discussions of their role are often linked to accusations of media manipulation and “spin” (Jones, 1995) and concerns that an increase in their numbers may “politicise” the permanent civil service (Rouban, 2003, Peters and Pierre, 2004). The fact that a number of countries manage to contain the number of political advisers at very low levels shows that they are not essential to running an effective administration. It is recommended to reduce or, wherever possible, to abolish political advisers, and to dismantle large political cabinets or offices attached to individual ministers.

Where did it occur?

It was not possible to collect systematic data on political advisers as defined in this study (see Box 11.1) for all of the countries studied. Nonetheless, the available data reveal remarkable variation. On one end of the scale, governments in the Netherlands and Denmark have hardly any political advisers while others employ hundreds of them. In particular in Australia and Canada, the use of political advisers appears excessive and savings could be obtained by drastically cutting their number.

Analysis

Advisers can be used to support a minister’s work from a partisan and tactical perspective, and to handle relations with the media (OECD, 2011). Their use is particularly wide-spread in only some of the countries covered by the study. In Canada, Ministers receive resources to establish their offices, for which they are personally responsible. Ministerial offices provide Ministers with access to advisers and assistants who are not ministerial public servants, who share their political commitment, and who can complement the professional, expert and non-partisan advice and support of the public service. Such “political” or “exempt” staff have no authority to give direction to public servants, but they can ask for information or transmit the Minister’s instructions, normally through the Deputy Minister (the most senior civil servant in a Canadian government department – see previous section). A Minister personally appoints exempt staff members. A Minister’s office may also include a maximum of seven “departmental” staff members. These are civil servants who are seconded from a ministry to a Minister’s office and expected to carry out their duties in a non-partisan manner. Their role is to liaise with the ministry as well as to provide administrative support and general assistance to the Minister on ministerial or other government matters. The Prime Minister’s Office has a particularly large body of political advisers, approximately 55 at the time of the survey.

The use of political advisers is also extensive in Australia, despite the fact that incoming governments typically promise to curtail their use. In Australia, a minister has a range of appointees that can be regarded as political advisers in terms of the definition used for this study. Most support staff are employed under the Members of Parliament (Staff) Act 1984 and allocated by the Prime Minister. The hierarchy includes Principal Adviser, Senior Advisers (including the Chief of Staff), Media Adviser, Adviser, Assistant Adviser, Office Managers and administrative assistants. According to the country assessment of Australia prepared for this study, the number of ministerial advisers employed by was 280 at 30 June 2010 (this excludes 86 executive assistants, office managers and secretarial/administrative staff, as well as staff working in ministers' electorate offices).

Other governments, too, use political advisers. Ministers in New Zealand typically have political advisers as part of their ministerial office of 7-12 staff in total. Eichbaum and Shaw (2007) document an increase of ministerial advisers in New Zealand from 39 in 1998 to 53 in 2006. Their count includes Ministerial Advisers, Senior Advisers, Executive Assistants, as well as press and media staff. Swedish government ministers have, on average, more political advisers than their colleagues in other Nordic countries. In Sweden, each minister has at least one adviser and at least one press secretary, and some ministers have about ten such staff. In Finland and Norway, ministers can have more than one political adviser but their overall number is typically small. In Norway only the prime minister has more than one political advisor. Many Finnish ministers have only one political adviser.

At the other extreme are countries that greatly restrict the number of political advisers. In the Netherlands, ministers may have just a single political assistant for their relations with their party and the Parliament. The Netherlands also claim that merit-based recruitment to the top civil service positions means that 99% of such appointments are free from political party interference. Danish ministers, too, are allowed to appoint just a single political adviser, who primarily serves as a spokesperson and press officer. However, not all Danish ministers employ such an adviser (Expert Committee on Civil Service Advice and Assistance to the Government and Its Ministers, 2004).

Box 11.5. Better governance frameworks for ministerial advisers

In 2010, the OECD carried out a separate survey of ministerial advisers in 27 countries. The survey points to several governance issues, such as the challenge to delineate the respective roles and responsibilities of ministerial advisers and public servants, and the problem of politisation of the public service. It also highlights common public concerns, including the sheer number of ministerial advisers, and the lack of transparency in their appointments and conditions of service. According to the study, their close interaction with the private sector and role in policy formulation might make ministerial advisers “particularly vulnerable to undue influence, which may put their integrity at risk”. The report concludes that there remains considerable room for improvement in developing a clear governance framework for ministerial advisers, and identifies the following potential areas of reform:

Box 11.5. Better governance frameworks for ministerial advisers
(continued)

- Clearly stating advisers' job descriptions, delineating their power and functions as distinct from those of senior public servants and setting the boundaries they may not overstep.
- Setting clear standards of integrity specifically for ministerial advisers and ensuring that they disclose their private interests pro-actively to identify and prevent conflict of interest.
- Increasing transparency not only in respect to the number of advisers but of their overall cost, profiles and competencies.
- Clarifying the accountability structure governing ministerial advisers.

Source: OECD (2011).

Feasibility of the reform

Reductions in the number of political advisers might be particularly popular with the electorate, given frequent concerns in relation to these posts in the media and public debates in many countries (see Box 11.5). From a purely practical perspective, there is no evidence that governments function any worse without political advisers, or when their number is strictly limited.

Reform 11.4. Simplify cabinet committee structures

Characteristics of the reform

This reform consists of the simplification and possibly the abolition of cabinet commission structures. The organisation of cabinets is diverse, and in part reflects the differences in their size highlighted in the first reform of this Chapter (11.1). Weller (1980) documents how committee systems were introduced in attempts to manage large cabinets, sometimes as an alternative to ministerial hierarchies that exclude some ministers from cabinet proceedings. The reduction in the number of ministers to 15 would eliminate this rationale and thus enable savings in the machinery that supports the cabinet. Smaller cabinets require fewer cabinet committees in order to ensure that decisions are properly co-ordinated than larger executive structures.

Where did it occur?

The study country that most closely reflects the proposed benchmark is Sweden, where cabinet functions without any cabinet committees. While the Anglophone study countries cluster together and illustrate the correlation of cabinet committees with the number of ministers, the extensive use of cabinet committees in Spain is – given the compact size of the country's cabinet – perhaps surprising. Although the data collected for the study is not complete, it is evident that there remains significant scope to reduce the number of cabinet committees in several countries, in particular Australia, Canada, New Zealand and Spain.

Analysis

Surprisingly, although cabinet committees exist in probably most countries, there are very few systematic studies of them (Mackie and Hogwood, 1984, Puszkar et al., 2010). This dearth of scholarly work contrasts sharply with the attention given to the topic by legislative scholars, who highlight the role of committees in ensuring effective decision making, notably by controlling the policy agenda and enforcing bargains (Shepsle and Weingast, 1981, Weingast and Marshall, 1988). Moreover, legislative organisation into committees can enhance productivity by allowing different policy items to be processed simultaneously. In the context of executive decision making, certain cabinet committees can also be important for ensuring that particularly urgent government decisions are made with a minimum of delay, for instance in response to an acute security threat.

Mackie and Hogwood (1984) surveyed the use of cabinet committees in 19 OECD countries with parliamentary systems of government. According to their results, the cabinets in 16 of these 19 countries used cabinet committees. The exceptions were in countries that either had a small number of ministers (Iceland and Luxembourg) or cabinets characterised by comparatively low levels of ministerial turnover (Sweden). Small cabinets are more likely to be able to manage collective decision making without further delegation to committees. In countries where ministerial turnover is comparatively low, alternative and more informal methods for making joint decisions may evolve, so that formal cabinet committee structures are needed less.

Table 11.2. The number of cabinet committees

Country	Total number	Delegated authority
Australia	8	n.a.
Canada	6	1
Denmark	5	n.a.
Finland	4	0
New Zealand	12	n.a.
Norway	3	1
Spain	11	0
Sweden	0	0

Notes: The final column gives the number of cabinet committees that have delegated decision-making authority; n.a = not available

Source: Response to Value for Money questionnaire.

Eight countries supplied data on the number of cabinet committees (see Table 11.2). Of those who responded, only one does not use cabinet committees (Sweden). The largest numbers are in New Zealand (12) and Spain (11), followed by Australia (8) and Canada (6), Denmark (5), Finland (4) and Norway (3). Although this sample is small, it is striking that the Nordic countries have few or no cabinet committees, while their number is above average in countries with Westminster systems. This at least partly reflects the fact that this last group includes countries with a large number of ministers (see Figure 11.1). The fact that the number of cabinet committees is positively correlated with cabinet size reflects the need to ensure functionality in large, potentially unwieldy and unstable decision-making bodies (Shepsle and Weingast, 1981, Klimek et al., 2009). While many cabinet committee structures reflect the main areas of government activity, others are

temporary and deal with currently salient political topics. An example of the latter is Canada's Cabinet Committee on Afghanistan (see Table 11.3).

Table 11.3. Cabinet Committees in Canada

Name	Mandate
Cabinet Committee on Priorities and Planning	Provides strategic direction on government priorities and expenditure management, ratifies committee recommendations and approves appointments.
Cabinet Committee on Operations	Provides the day-to-day co-ordination of the government's agenda, including issues on management, legislation and house planning, and communications.
Treasury Board	Responsible for accountability and ethics, financial, personnel and administrative management, comptrollership, approving regulations and most Orders-in-Council.
Cabinet Committee on Social Affairs	Considers health care, justice, Aboriginal issues, training and skills development, culture and immigration policy issues.
Cabinet Committee on Economic Prosperity	Considers sectoral issues including international trade, sustainable development, natural resources, fisheries, agriculture, transport, infrastructure and communities, and regional development, as well as environment and energy security and other longer-term matters concerning Canada's economic growth and prosperity.
Cabinet Committee on Foreign Affairs and Security	Considers foreign affairs, international development, public and national security, and defence policy issues.

Sources: Response to the Value for Money questionnaire and update from the Canadian Treasury Board Secretariat.

Only four of the nine countries with cabinet committees supplied responses on how many of these lack delegated decision-making authority. In Spain and Finland, none of the cabinet committees has delegated authority. In Norway, only the Government's Committee on Security has independent authority. However, even when cabinet committees do not have independent authority to make decisions, their influence on cabinet deliberations and decisions should not be underestimated. Given the limited time available, committee recommendations invariably shape cabinet discussions. This suggests that, in some countries, cabinet committees are *de facto* responsible for making a large share of cabinet decisions. One study estimates that in some years, Australian cabinet committees have taken "up to 50% to 60% of final decisions" (Weller, 1980:608).

These diverse patterns do not reflect any obvious differences in cabinet workloads. Almost all of the cabinets included in this study meet on a weekly basis (except in Canada, where the cabinet meets every two weeks), and thus have similarly limited time to make necessary decisions. It is possible that the above cross-country variation with regard to cabinet committees reflect differences in the use of alternative co-ordination mechanisms. For instance, Mackie and Hogwood (1984) outline a number of additional "arenas" in executive decision making, including unilateral decisions by individual ministers, internalised co-ordination where one minister heads a number of related ministries, bilateral negotiations and party decisions.

In most survey countries, the Chancellery or Prime Minister's Office typically provides administrative support for the cabinet, for instance by circulating papers and taking minutes. The Prime Minister's support structures can also include a number of policy advisers that service cabinet committees and ensure co-ordination across ministries. Although the survey did not collect comprehensive data on the size of these bodies, figures provided by respondents varied greatly. For example, the Norwegian Office of the Prime Minister consists of about 60 people, whereas the Finnish equivalent employs four times this figure, i.e. 240. The role these structures play in terms of policy

development and co-ordination also varies significantly across countries, in part depending on the degree of ministerial autonomy in policy development.

Feasibility of the reform

The feasibility of simplifying or possibly abolishing cabinet committee structures, where applicable, is conditional on maintaining a modest size of the cabinet. Where cabinets are large, a case can be made that cabinet committees are required for effective collective decision-making. However, the recommended reduction in cabinet size substantially weakens or eliminates this rationale.

Notes

1. An example of the latter is the appointment by the French Government of a Minister of Free Time (*Ministre du Temps libre*), André Henry, from 1981-1983, which was linked to new initiatives promoting broader access to leisure activities. See Shaw and Williams (2002), p. 74.
2. Apart from the Prime Minister, there are 27 ministerial positions in Canada, which are held by 25 ministers (in other words, two ministers are cross-appointed to other positions).
3. Dunleavy and White (2010) studied the reorganisation cost for several Whitehall departments, covering accommodation, HR systems integration, information technology investment and integration, differential pay settlements as well as productivity losses and find that these costs ranged from GBP 15 million to GBP 31 million in the case of the creation of three new departments, while one large-scale amalgamation of social security and employment services was substantially more costly (GBP 175 million). Some of these were one-off first year costs, but in two cases (the two most expensive reorganisations), recurring costs amounted to 48% and 81% of the total.

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Chapter 12

Steering of agencies

This chapter focuses on agencies of the central government. Agencies are defined as units of a ministry with a separate financial administration. They can be divided in arm's length agencies, that are subject to the ministerial responsibility as far as (executive) policy is concerned and independent agencies that are not subject to ministerial responsibility as far (executive) policy is concerned.

In most countries included in the study agencies have become the most important form of organisation in the central government. They employ a large majority of civil servants and they are the most used form of organisation for two of the four government tasks: policy execution and administrative regulation and supervision.

In the era of New Public Management the dominant view on the steering of agencies was the results oriented governance model. This model implied that agencies should be financed on the basis of outputs and costs. In practice this model has never fully been implemented. Agency outputs are hard to define, politicians often change their minds about output targets and sanctioning leads to perverse incentives.

Current steering practices evolve in the direction of a permanent performance dialogue between agency directors and officials in the core ministry who are responsible for policy development. A permanent performance dialogue makes it possible to steer agency activities from day to day in light of experience and new political demands.

As far as financing is concerned, current trends go in the direction of “capacity budgeting” which focuses on the costs of capacity to meet the politically agreed needs. Capacity costs can be divided into fixed and variable costs. Both types of costs are subject to negotiation between agencies and core ministries. At the side of ministries the finance directorates, as economic owners of the agencies, are the units most suitable to conduct these negotiations. However, the expertise of these owners on the costs of the production processes in the agencies can be improved in many countries.

The current chapter presents three reforms: one on the steering of outputs and two on the financing and ownership of agencies, which can lead to substantial efficiency savings.

Introduction

Agencies as organisations in central government

Agencies have been defined in this study as units of a ministry with a separate financial administration. They can be divided in arm's length agencies and independent agencies. The former are defined as agencies for which the minister is responsible as far as executive policy is concerned (not necessarily for the handling of individual cases). The latter are defined as agencies for which the minister is not responsible, nor for executive policy nor for the handling of individual cases. The minister remains responsible for operational management for both arm's length and independent agencies.

In most countries included in the study agencies have become the dominant form of organisation in the central government. As shown in Chapter 2, agencies employ the large majority of civil servants, they are the most used form of organisation for two of the four government tasks: policy execution and administrative supervision and regulation and they are used increasingly for support service delivery, especially at the central level.

In spite of this development, interest in the functioning of agencies has remained modest. This is regrettable because the organisational form of agencies is not without problems and it can be argued that the agency movement has led to loss of control on the efficiency of service delivery and the quality of services. For this reason the current study has paid much attention to agencies and the reforms that are currently taking place in the area of agency governance.

Chapter 2 has provided statistical information about the current role of agencies in the central government of the participating countries. Chapter 4 has paid attention to the distinction between arm's length agencies and independent agencies and focused on the role of these kinds of agencies in policy execution in various countries. It has also presented several reforms that are currently undertaken in the UK, Sweden and the Netherlands in reaction to the problems that have arisen (Reforms 4.2 and 4.4). Chapter 5 has paid attention to the use of independent agencies in administrative supervision and regulation. This current chapter focuses on the steering and financing of agencies, in particular administrative agencies (as opposed to agencies tasked with in-kind service delivery such as universities, hospitals, cultural institutions, etc.).

Whereas agencies have existed in several countries before the 1990s, in particular Anglo-Saxon countries and Sweden, the agency movement of the 1990s led to a more general shift of policy execution out of the core ministries, and into agencies, both in countries where agencies already existed, and in countries that thus far had organised policy execution mostly in the core ministries. Moreover, the agency movement, which started in the UK with the "Next step agencies" introduced by the Thatcher cabinet, added an important new component to the separation between core ministries and agencies, namely the results oriented governance model. This model was inspired by the ideas of New Public Management (see Chapter 1). This model implied that agencies should be financed and steered on the basis of outputs and costs. According to this model agency managers should have substantial autonomy in the organisation of the production process, in particular in decisions about the input mix, and should be accountable for outputs and costs per output. This model was introduced from the start in the new agencies established in the 1990s but was henceforth also applied to agencies that already existed in several countries long before the agency movement.

Problematic aspects of the results oriented governance model

The shift of policy execution and administrative supervision and regulation outside the core ministries is generally seen as successful in the countries where it occurred. The separation of policy execution from policy development has led to better insight in the costs of both tasks. Moreover, it is generally acknowledged that policy execution requires other forms of expertise than policy development, even if it is assumed that it may be useful for top managers to gain experience in both areas. In addition, the separation may in principle lead to better control of the production process, and thus to better services and lower costs, supposed that the steering and financing of agencies is well organised. However, this is currently not always the case, partly because of conceptual deficiencies in the results oriented governance model. These deficiencies are of three kinds.

First, output¹ is hard to define and heterogeneous. Financing of outputs becomes then illusory. A recent evaluation in the Netherlands showed that, in contradiction to explicit policy, input financing is in practice still dominant in agency financing arrangements (Ministry of Finance of the Netherlands, 2011). Integral cost prices play in practice little or no role in the negotiation between agencies and core ministries. Negotiations focus on the costs of inputs. Integral cost prices are sometimes calculated after the budget has been agreed between ministry and agency in order to comply with regulations that are based on unrealistic assumptions. Steering is not realised via output financing. Even if outputs are more or less homogeneous and definable, they are not used for financing, because most agencies are monopolists. Lacking market prices, their service costs can only be assessed on the basis of input costs.

Second, steering on outputs requires agreements about budgets and targets for quantity and quality of services. However, the quality of services cannot be captured in formal agreements. Steering on formal quality criteria, leads to perverse incentives. In the private sector, contracts play only a limited role in quality control. The basic quality ensuring mechanism in the private sector is competition in combination with the profit motive. Socialist experiments with steering on formal quality criteria in the private sector have failed (“Stalinist economics”). Moreover, in practice it appears that politicians continually change their minds on what has to be produced. This is logical, because political preferences change, insights in the usefulness of services change in the light of new social and economic research and social and economic circumstances change, affecting the needs for services. Therefore in practice steering takes place on a continuous basis by contacts between ministries and agencies, even if these contacts are not formally recognised as a steering mechanism.

Third, if formal targets for quality and quantity of services are not achieved, politicians are little inclined to apply financial sanctions². This is understandable, since politicians want to realise their targets. They would rather reform policies and increase expenditures than apply financial sanctions. This is only different if the shortfall in service provision is seen as a policy success. Many services are aimed at helping households or businesses in difficulty. In those cases the broader policy target is often to prevent that clients get in difficulty and need the service to begin with. This implies that successful policy implies reduction rather expansion of the service. This notion is captured by the expression “capacity budgeting”: budgeting for agencies should be based on sufficient capacity to provide the services if needed. Successful policy often means that the services are not needed.

Reforms of this chapter

In the Netherlands and Sweden, the recognition of permanent steering has led to a split in the roles of the core ministry in financing on the one hand and supervision of executive policy (steering) on the other hand. As soon as this split is recognised, it can formally be attributed to two different units in the core ministry. The financing role is often fulfilled by the permanent secretary, supported by the financial directorate. The steering role is often attributed to the policy making directorate (the tax policy directorate for the tax service, the directorate of law enforcement for the police, etc.).

This chapter contains three reforms that have been introduced in recent years to remedy the mentioned problematic aspects of the results oriented governance model for agencies. The first focuses on output steering in a permanent performance dialogue (Reform 12.1). The second focuses on financing of agencies (“capacity budgeting”; Reform 12.2). The third focuses on a more professional execution of the economic ownership role of the agencies, which includes the financing task (Reform 12.3).

Reform 12.1. Output steering in agencies

Characteristics of the reform

The reform consists of setting, monitoring and evaluating performance targets and realisations in a year-round performance dialogue. This task should be fulfilled by the line ministry that is responsible for executive policy of the agencies. It is important that the officials who are responsible for steering and control in the line ministry are the same officials who develop policy for the agencies. The strong side of this arrangement is that the dialogue becomes more meaningful because both parties have good understanding of the policy area.

Where did it occur?

In the last few years, the arrangements for the steering and control of agencies have been reconsidered and reformed in various countries. A prevailing trend in these countries is separating steering from financing of agencies. Sweden is in this respect the most inspiring country.

Analysis

Background of shifting from cost control to permanent performance dialogue

Agencies are not responsible for the effectiveness of policies. That is the task of core ministries who are responsible for policy design (see Reform 3.5 on Evaluation). However, policy design leads to the implementation of policy instruments and some instruments require executive actions (outputs). Financial instruments and some non-financial regulations needs to be applied in individual cases (paying grants, subsidies, social benefits, granting permits, licences, concessions, admissions), services in kind have to be produced and provided.

New Public Management had two consequences for steering and control of policy execution. First, it led in a number of countries to the separation of policy development

and policy execution. The latter task was devolved from ministries to agencies with a separate financial administration. This reform recognised that policy execution requires different skills and working methods than policy development and led in general to better results in the performance of both tasks. Second, it increased insight in the cost of outputs (both administrative services, such as payments of social benefits or subsidies, and services in kind such as employment mediation services and police services). These results are generally seen as positive.

However, New Public Management also changed the nature of the steering relation. When executive agencies were regular divisions of the ministry, steering of executive units took place on a daily basis in virtue of the regular ministerial hierarchy. The conception of New Public Management was that steering would henceforth be based on output targets and realisations, rather than on daily interference in the production process. Agencies would be autonomous as to the use of inputs and the input mix. Accountability would exclusively be based on output targets and realisations.

However, as argued in the introduction of this chapter, output targets are inherently volatile, both in terms of quality and quantity. New insights on the effectiveness of policies lead to reform of policy instruments. Moreover politicians change their minds in the light of new political priorities or new political agreements. For these reasons the process of performance steering must be a permanent process, in which agency activities can be adjusted from day to day.

Financing of executive tasks does not require daily adjustment. Within a broad margin the resources required for the execution of policy instruments can be held constant from year to year. Many costs are fixed and variable costs do not always need adjustment if new instructions are issued on the quality of outputs or the output mix.

Separating steering of agency performance from the annual budget process is an important trend in several countries. The annual exercise to agree on output targets within the budget process is increasingly seen as ineffective, bureaucratic and distortive (leading to perverse incentives). Output steering and control should take place on the basis of a permanent performance dialogue. The counterpart of the agency in this dialogue is not the financial directorate (as is the case in budget negotiations), but the directorate that is responsible for policy development.

Inter-ministerial agencies and service centres

A special case arises if agencies have the character of inter-ministerial common process units and shared service centres (see Reforms 4.2 and 6.1). In this case, the owner ministry is not only responsible for the financing and operational management of the common process unit or shared service centre but also for the effectiveness of the permanent performance dialogue between the client agencies and the management of the common process unit or service centre. In particular, the owner ministry has to ensure that the client agencies are represented in the team that conducts the performance dialogue and diverging interests among the clients are reconciled before the dialogue starts. The leading role of the owner ministry in the performance dialogue should guarantee that the client ministries cannot be played out against each other and that they are all served in accordance with their financial contribution (see Reform 12.2 for the partition of costs).

Sweden

Sweden has developed annual performance procedures that to a large extent bypass the budget process. Important elements are the performance dialogue with the minister (supported by the relevant policy directorates) on the basis of the annual agency report, the meeting with the Swedish National Audit Office on the basis of the audit report, and various forms of evaluation. With respect to performance reporting Sweden has reduced the role of the annual Agency Directive attached to the appropriation, and enhanced the role of the Agency Ordinance.

The Agency Ordinance, which is a set of rules put up for each separate agency, is the formal basis for the steering of Swedish agencies. It contains rules about the remit of the agency, its reporting requirements, ministry-specific rules of operational management and general instructions about executive policy. Next to the Agency Ordinance, each agency receives an annual Agency Directive that specifies its budgetary resources and contains instructions about performance targets. In addition to these formal documents, agencies are supposed to conduct a regular dialogue with their parent ministry about budget execution and performance results. The organisation of this performance dialogue is different between agencies. Large agencies, such as the Tax Office, have monthly meetings with the parent ministry, the Ministry of Finance in this case, and may have frequent contacts by telephone or email in between meetings. In the case of small agencies, the contacts may be less frequent. However, by way of principle, agency managers are supposed to conduct a continuous performance dialogue with the parent ministry. On the part of the ministry, the division that is responsible for policy development is the counterpart in this dialogue. Furthermore, in most cases, the minister meets with the agency management at least once a year to discuss the annual agency report.

In 2009 the Swedish government reformed its procedures for agency steering with a view to more stability and more pragmatic working methods. The Agency Ordinance (agency instruction) has become the key policy document for the government's management of agencies. The agencies are henceforth reporting performance in relation to their tasks in the Agency Ordinance. This reflects a change in approach based on the conviction that the agencies are generally in a good position to decide what information best describes their own activities. It gives the agencies more freedom in their reporting task. Furthermore it leads to consequences for the core ministries (the "Government Offices") as well, in that they can henceforth focus more on strategic matters. Finally, the reform has led to greater flexibility in the design of the government's reporting of results to the *Riksdag* (the Swedish Parliament).

In their annual reports, agencies must report and comment on the results of operations in relation to the objectives and tasks, and in accordance with the reporting requirements laid down in the Agency Ordinance. If the government has not determined special reporting requirements, the agencies are to report their performance in relation to volume, costs and quality. An agency's annual report is to be drawn up in accordance with generally accepted accounting principles, which implies that it has to give a true and fair picture of the results, costs, revenue and financial position of the agency. Annual reports are examined by the Swedish National Audit Office. The examination covers the entire annual report and aims to assess whether the report and the underlying report, as well as the accounts, are reliable.

Box 12.1. Steering of the Employment Service Agency (ESA)

The ESA is the largest agency (30 000 staff, 321 local offices, and annual turnover of SEK 70 billion) in Sweden. It is an arm's length agency subordinate to the Swedish Ministry of Employment.

The mission of the ESA is to help matching job-seekers and employers while prioritising people who have difficulties gaining access to the labour market. The ESA also promotes social inclusion. In 2012 the efforts of the Agency were focused on counteracting long-term unemployment and increasing the number of one-on-one meetings.

The steering of the ESA is performed on the basis of an Ordinance (Instruction 2007:1030), annual Directives and reports (30-40 reports per year). The forecasts for present and future needs prepared by the ESA five times per year can also serve as a supporting document for performance assessments. There is a permanent performance dialogue between the agency and the Ministry of Employment. Considering the large size of the Agency and the increased importance of the employment area in the post-crisis environment, the dialogue between the Agency and the Ministry is ensured by constant communication and frequent meetings. The Minister or the Director General of the Ministry meets on a monthly basis with the Director General of the ESA to discuss strategic issues. The meetings at the technical level take place twice per month or more frequently. Importantly, the performance dialogue involves relevant experts from both the Agency and the Minister who have good insights of the Agency's activities. On the side of the ministry, it is the division for employment (the largest of the seven divisions in the Ministry) which is responsible for policy development for the Agency and for its steering. An assigned expert from this department ensures the communication with the ESA. On the side of the ESA there are two contact persons to provide insights and any relevant to performance information.

According to the legislation, it is up to the agency to assess which kinds of performance are essential to its operations. Performance dialogue and assessment are supported by the information and targets provided in the Ordinance, annual Directives, and reports. The reports contain extensive information about results, statistics and facts of the ESA's activities and are being scrutinised through the ongoing dialogue between the parent ministry and the Agency. The recent trend in ESA performance management is further adjustment of the Ordinance as the key document for agency steering in terms of performance and removing all quantified targets (or replacing them by softer formulations that take better account of changing priorities) from the annual Directives. Removing quantified performance indicators or targets established from the annual Directives is intended to prevent unintended and distorting consequences of the performance assessment process. The focus in the performance dialogue has shifted from establishing performance indicators to scrutinising extensive reports and drawing conclusions about performance on a case-by-case basis. For instance, the targets established in the 2012 Directive included preventing long-term unemployment, early (preventive) interventions, and more frequent meetings with job-seekers. In 2012 the ESA had chosen to report customer contacts as its essential performance indicator.

Source: Provided by the Ministry of Health and Social Affairs.

Feasibility of the reform

A better separation of agency steering and agency financing is useful and feasible in most countries that have devolved policy execution to agencies. In this regard the Swedish procedures can be seen as best practice from an international perspective.

Reform 12.2. Financing of agencies

Characteristics of the reform

The reform consists of keeping financing of agencies apart from the steering of agency outputs. Budgeting of agencies should be based on robust rules for the fixed and variable costs of the agency's required production capacity in the light of the estimated needs for its services (capacity budgeting). Agencies should be required to provide transparent information on the input mix and the input costs that allow the owner minister to assess the capacity costs of the agency.

Where did it occur?

The separation of steering and monitoring from financing of agencies is a recent development in several countries that fits into the wave of current reforms aiming to remedy deficiencies of previous reforms that were inspired by New Public Management. Sweden is the clearest example. This country has a centuries-old tradition of devolving executive tasks to arm's length agencies. However, separation of policy execution from policy development is not the same as separation of steering from financing of agencies. In the 1990s the financing of agencies was affected in Sweden by the ideas of New Public Management in a similar way as many other countries, leading to an increased emphasis on output targets and performance in the financing of agencies. However, current Swedish reforms aim to remedy the unexpected consequences of this trend and go further in this respect than similar course corrections that are taking place in other countries. It can be argued that the long experience of Sweden with the financing of agencies, largely explains this early awareness of the need for adjustment.

Analysis

Budgeting of agencies and the budget cycle

Financing of agencies is generally provided from the State budget, although some agencies can generate their own revenues. Most agencies are part of the State; they don't have legal personality. This implies that their non-tax revenues, even if they are earmarked for the agency's services, are authorised by the state budget (the gross budgeting principle) and their use is subject to the control of the owner ministry. This is true for arm's length agencies as well as for most independent agencies in the sense of the current study (in particular independent agencies without legal personality³ (see Reform 4.3 for the specific features of independent agencies).

Countries have different practices concerning the authorisation of agencies' budgets. In most countries the expenditures for the services provided by the agency, for instance social benefits, subsidies, grants to local governments (programme expenditures), are kept apart from the operational expenditures of the agency and authorised in the budget of the core ministry. In Sweden however, the expenditures for the services provided are part of the agency budget and distinguished as separate line items within the agency budget.

Another distinction concerns the specification of the operational expenditures of the agencies. In some countries they are authorised in a single line item, which in principle allows large discretion for the agency's management to decide on the quality of inputs and the input mix. In other countries, the State budget authorises separate line items for broad input groups such as compensation of employees and intermediate consumption. If the operational expenditures are authorised in a single line item, the agency's budget is

sometimes specified on an accruals basis in the budget documentation. The latter is for instance the case in the Netherlands. This gives the government and parliament an insight in the operational management of the agency that can be used as background information for the assessment of the line item that authorises the agency's operational budget.

The financing of agencies is an annual process that is part of the regular budget process and subject to the same constraints. If there is a budgetary framework in place that puts ceilings on ministerial budgets, the ministries have to make sure that the operational budgets of all agencies under their umbrella fit into the overall ceiling for the ministry⁴. For this purpose the minister, often represented by the financial directorate of the ministry, has to negotiate with all agency heads in the same way as it has to negotiate with the directorates in the core ministry. If a country works with baselines that are regularly updated (see Reform 7.2) these negotiations usually focus on additional spending requested by the agency (above the baseline), or on savings proposed by the financial directorate (below the baseline). This process of intra-ministerial budgeting usually precedes the submission of budget requests by the line ministry to the Ministry of Finance. After the intra-ministerial budget process is completed, the minister takes a final decision on the allocation of the ministerial budget over all programmes and over the operational expenditures of all agencies and the core ministry.

In the 1990, as a consequence of the ideas of New Public Management, there were attempts in many countries to change the nature of budget negotiations between ministers and agency heads. Traditionally, the negotiations focused on inputs, but the focus shifted to the cost of service delivery (outputs). For this purpose it was necessary to define the services and to calculate total costs per service taking into account both the fixed and variable operational costs of the agency. In theory the budget negotiations could then focus on the service package to be delivered and the costs per service.

In practice this change has largely been fictitious because, in the absence of relevant market prices, costs can only be assessed on the basis of underlying assumptions about the input mix and the input costs. In order to carry out negotiations effectively, an agency's input costs therefore have to be transparent and the minister needs assistance from advisors having thorough knowledge of the agency's organisation and production methods. These advisors are typically to be found in the financial directorate of the line ministry. This implies that if the agency's services are steered by the policy divisions of the ministry (see Reform 12.1), there is a division of tasks between the financial directorate, that is responsible for efficiency, and the policy divisions, that are responsible for the quantity and quality of the services to be delivered by the agency.

This separation of responsibilities ensures that deficiencies in the quantity or quality of service delivery does not lead to budgetary sanctions and thus to perverse incentives. It also reflects the reality that politicians typically react to problems in the sphere of effectiveness by pushing for policy reform, not by withholding resources. This is understandable because the objectives they are trying to achieve do not become less valuable if current policies appear to fail.

The separation of financing from steering and monitoring implies that financing can focus on inputs. Inputs can be divided into fixed costs (buildings, overhead from management and support services) and variable costs related to the volume of services. For the purpose of financing it is important that services are broadly defined and not dependent on specifications on quality that are subject to the steering regime. This approach to variable cost financing is sometimes denoted as the $p * q$ approach.

Furthermore, the separation of financing from steering and monitoring implies that service volumes should not be interpreted as output targets, but rather as need indicators under given policies. Financing of agencies should ensure a sufficient service capacity to satisfy current needs, even if policy targets are aimed at reduction of needs. This can be called: capacity budgeting.

For instance, the costs of penitentiary institutions can be based on the normative costs of sufficient prison capacity and the expected number of incarceration days (not on targets for incarcerations days). The costs of primary education can be based on normative costs of buildings and equipment and normative teacher salaries in view of a student/teacher ratio (not on targets for “classroom hours”).

Currently, line ministries’ information about the costs of agencies is limited, particularly for the more autonomous arm’s-length agencies and the independent agencies. In view of the fact that by far the largest part of operational expenditure is made in the agencies, it is clear that substantial savings from efficiency improvements, if any, can only come from agencies (from all agencies, including the more autonomous and independent ones). In this light, there is every reason for governments to focus their attention on better cost information about agencies. Although the financial directorates should have the leading role in this effort, it is important that the Ministry of Finance supports this effort (Second line control, see Reform 12.3).

Inter-ministerial agencies and services centres

A special case arises if agencies have the character of inter-ministerial common process units and shared services centres. In this case, it is important that the ministry which owns the unit or centre remains fully accountable for its operational management and efficiency. This can only be achieved if the financing relation with the unit or centre remains firmly in the hands of the owner ministry. Otherwise the client ministries obtain a unilateral monopoly position and can be played out against each other. Whereas it is appropriate that the client ministries and agencies communicate regularly with the unit or centre about the modalities of service delivery in a permanent performance dialogue, it is important that the ministry that owns the unit or centre be exclusively responsible for its financing. This is the only way that accountability for the efficiency of the unit or centre can be made effective. The client ministries and agencies of the unit or centre can be made to “pay” for the services provided by common process units or service centres by inter-ministerial reallocation of the resources concerned. This will be reflected in the reduction of the line items from which the resources are taken (usually operational expenditures of core ministries and agencies).

Sweden

Sweden has made substantial progress in separating budgeting from output steering and monitoring, and in implementing procedures for the collection of reliable information about the costs of agencies. In Sweden agency budgets include both operational and programme expenditures.

Swedish agencies are subordinate to government and are not independent in the sense that they cannot set their own executive policies. On the other hand, they do enjoy autonomy, by way of principle, as far as decisions in individual cases are concerned. Also, they enjoy a certain autonomy with respect to the way they organise themselves and use their resources, subject, however, to standards of operational management that apply government wide.

Box 12.2. Financing of the Employment Service Agency (ESA)

The ESA is one of the 12 agencies under the umbrella of the Swedish Ministry of Employment. It is the largest agency in Sweden (see Reform 12.1). ESA is financed from the State budget. It also generates some small own revenues (from EU twinning projects, projects with developing countries or others). The budget of the Agency is developed in line with the central government budget cycle on an annual basis. The Agency prepares its draft budget for the upcoming year by March and submits it to the Ministry of Employment. In September, after discussions with the Ministry of Finance, the Ministry of Employment submits the draft budget to Parliament. The final version of the budget is adopted in December.

The budget appropriations for the ESA are distributed in four main groups:

1. operational expenditures (in the 2012 budget SEK 7 billion);
2. support to the unemployed (e.g. insurance payments, labour market educational programmes, activities support; in the 2012 budget SEK 31 billion);
3. specific programme costs (e.g. transfers to schools; in the 2012 budget SEK 8 billion);
4. wage subsidies (transfers to the employers hiring certain categories of employees; in the 2012 budget SEK 13 billion).

ESA is responsible for both operational expenditures (appropriations in group 1) and for programme expenditures (appropriations in groups 2 to 4).

Operational expenditures are subjected to cuts of productivity dividends (depending on the inflation rate the cuts vary from 1 to 3 % per year; see Reform 7.5). The programme expenditures are mostly defined by entitlements; therefore the agency cannot substantially influence expenditure levels under these budget lines or produce any savings. The baselines for expenditures under groups 2-4 are updated five times per year in light of forecasts. These updates can lead to supplementary budget laws. In the post – crisis period the forecasts about the unemployment level were often too pessimistic so that programme appropriations were not fully used.

Although the ESA is granted with rather broad spending authority, there are constraints with regard to the programmes to be undertaken and financed. These limits are defined by both the budget law (which specifies the separate appropriations) and by the annual Directive (see Reform 12.1). For example, the 2013 Directive stipulated that SEK 46 million should be spend on programmes stimulating youth employment and SEK 11 million should be directed to programmes promoting youth employment. Both programmes fall under group 3 of the budget appropriations. Constrained by programmes defined in the budget law and Directives, ESA could not spend all of its resources within a budget year. Underspending is often perceived by politicians and public negatively, but it also shows that the programme classification in the annual budget law and the Agency Directives are necessary constraints to avoid non-intended spending.

Summarising, the annual budget process of ESA is separated from the steering process. In this way perverse incentives are avoided. The established procedure of budget formulation ensures full transparency of input costs and allows the Ministry of Employment to assess the efficiency of the Agency's operations.

Source: Provided by the Ministry of Health and Social Affairs.

Feasibility of the reform

The Swedish approach to the financing of agencies is characterised by separation of financing from steering and control and by full transparency about input costs. In this approach the role of financing is limited to the insurance of service delivery capacity, whereas steering and control has to ensure performance. These features are not dependent on the specific nature of the Swedish agencies but are applicable in all countries that have organised policy execution in agencies with their own financial administration.

Reform 12.3. More professional ownership of agencies

Characteristics of the reform

The reform consists of a more professional execution of the economic ownership role of agencies by line ministries. This implies that the line ministries must improve the financing arrangement for the agencies under their umbrella, reserve more capacity in their financial directorates for the financing of agencies, collect more information about the efficiency of the agencies and ensure that central and de-central standards of operational management are applied by agencies. It also implies that the Ministry of Finance reserves capacity for the support of the financial directorates of the line ministries in their supervisory tasks and conducts comparative research on the efficiency of agencies.

Where did it occur?

In the Netherlands a new approach towards the steering of agencies was taken in 2011⁵. This change of cap was based on an evaluation of the agencies by the Ministry of Finance (2011). The new approach puts emphasis on a more professional economic ownership role of the line ministries. The document that announces the new policy contains a number of guidelines that are not yet fully implemented.

Analysis

If a central government would organise all policy execution in arm's length agencies, this would imply that the agencies would employ around 95% of all civil servants. This is illustrated in the case of Sweden, where policy execution is tasked to agencies by way of constitutional principle (according to the snapshot of the public administration the Swedish agencies employ 96% of central government officials; see Chapter 2). This implies that if a government wants to make savings on operational expenditures, it has necessarily to focus on the agencies. However, in many OECD governments, line ministries have lost detailed knowledge on the production processes in agencies, partly as a consequence of ideas of New Public Management that stressed the responsibility of agency managers for the efficiency of their operations. This knowledge must be regained in order to enable line ministries to fulfil their role as economic owners⁶ of their agencies.

The analysis of agency behaviour requires a distinction between three roles:

- the role of the agency as executive unit;
- the role of the line ministry as principal of the agency;
- the role of the line ministry as economic owner of the agency.

In the two previous reforms of this chapter, it was shown that in Sweden, the roles of the line ministry as principal and economic owner have to a large degree been separated. The role of principal is carried out by the division of the line ministry that is responsible for policy development in the domain of the agency, the role of economic owner is carried out by the finance directorate of the line ministry. In the Netherlands this separation has to a large degree been carried through as well. Of the 44 Dutch arm's length agencies (in 2010) in 36 cases the economic ownership was separated from the principal role. Economic ownership was in these cases tasked to the (Deputy) Secretary General, whereas the principal role was played by the Director General responsible for policy development. In the 10 remaining cases economic owner and principal was the same Director General. In the case of the 65 budget financed independent agencies economic ownership is vested in the Secretary General. In these cases there is no principal because the agency is independent as far as its executive policy is concerned.

Whereas in the Netherlands economic ownership is always vested in a single ministry, agencies may have more than a single principal.

Table 12.1. Number of agencies per Dutch ministry

	0 agencies	1-2 agencies	2-4 agencies	>4 agencies	Total number of agencies
Number of ministries	2	5	2	4	13

Source: Ministry of Finance of the Netherlands (2011).

Table 12.1 shows the number of agencies per ministry and Table 12.2 shows the number of principals per arm's length agency (independent agencies have no principal).

Table 12.2. Number of principals of Dutch arm's length agencies

	1 principal	2-3 principals	> 3 principals
Number of arm's length agencies	20	11	13

Source: Ministry of Finance of the Netherlands (2011).

The economic owner was previously defined in the Netherlands as the authority responsible for “continuity, quality and integrity of the agency”. The principal was seen as responsible for the “policy budget and the policy results”.

The previously mentioned evaluation report observes:

- Output is often hard to define. Steering on output is then hard to realise.
- Input financing is dominant for many agencies. This is particularly true for agencies that produce non-homogeneous services or specific government services (or fraud abatement) where there is a government monopoly of production of services with a social value. For these kinds of services the total cost-price is not decisive for the question which service level should be delivered; the general interest simply requires that the tasks are executed. In these cases steering takes place on the basis of available budget.

The evaluation also provides information about the number of officials in the finance directorates of the ministries that are tasked with the supervision of the agency finances (see Table 12.3).

Table 12.3. Supervision by Finance directorates of ministries on agencies in the Netherlands (number employees in FTEs¹)

Ministry	1.FTEs supervision	2. FTEs Fin. Dir. ²	1:2 in percent	Number of ALAs ³	Number of IAs ⁴
Prime Minister's Office	0	11	4	1	0
Foreign Affairs	1	70	0	1	0
Interior	7	109	6	10	6
Defence	8	323	2	3	0
Economic Affairs, Agriculture and Innovation	15	149	10	8	12
Finance	1	31	3	2	3
Infrastructure and Environment	11	176	6	4	5
Education, Culture and Science	6	39	15	2	14
Social Affairs and Employment	7	114	6	2	2
Security and Justice	2	44	5	5	8
Health, Well-being and Sport	3	75	4	6	14
Total	60	1 227	5	44	65

Notes: ¹Employment in full time equivalents; ²Finance directorate; ³Arm's length agencies; ⁴ Budget financed independent agencies.

Source: Ministry of Finance of the Netherlands (2011).

It appears from this table that 60 of the 1 227 employees of Finance directorates of ministries are tasked with financial supervision of agencies. Ministries that own many agencies devote on average more resources to supervision than ministries that own few agencies, but the relation is not without exceptions (for instance Health Wellbeing and Sport owns many agencies but has little supervisory staff).

However, the mentioned evaluation also concludes that further professionalisation of the various roles is necessary. For this purpose additional capacity and expertise has to be created in the Finance Directorates of the ministries via reallocation. Moreover, according

to the evaluation the owner needs to fulfil a stronger role that is currently the case. The owner must not only focus on the continuity and the quality of the agency but also on the financing framework available for spending. This role has to be filled in more actively, also during the execution year. The Ministry of Finance should also focus more on agency financing, among other things by stricter supervision on the budget and accounting process of agencies and by periodic evaluations together with the Finance Directorate of the line ministry. As indicated by several principals, agencies and owners, the Ministry of Finance should also play a more horizontal role by conducting comparative efficiency analysis of agencies.

On the basis of the evaluation the Dutch Government has taken a number of policy decisions on the steering of agencies, including:

- the roles of principal and economic owner should be fulfilled by different officials;
- the expertise on the functioning of agencies and on the execution of the various roles should be increased by the development of an educational and training programme that should be mandatory for the officials that fulfil these roles as well as for their advisors and supervisors.
- supervision and control of agencies should be strengthened, both in the first line (Finance directors of ministries) as in the second line (Ministry of Finance, DG Budget). The DG Budget have started horizontal benchmarks and evaluations of agencies together with the Finance Divisions of ministries (every five years, if possible aligned to regular spending reviews).
- the strengthening of supervision and control of agencies (both in the first and second line) requires additional capacity. For this purpose a reallocation of available capacity has to take place.

In view of these decisions, it may be concluded that the task of agency financing in the Netherlands moves from the principal to the owner. It is to be expected that these decisions will have far reaching consequences for the financing of agencies and will lead in the medium term to substantial savings. It is interesting to note that these decisions imply an almost total reversal of the steering philosophy that led to the establishment of agencies in the first place (financing and steering on outputs, “let managers manage”). However, these decisions do not in any way imply a weakening of the separation of the agencies from the ministries as such. On the contrary the separation of policy development from policy execution is still seen for many reasons as a successful result of the reforms of the 1990s on which the current reforms build on, albeit in a different direction than originally envisaged.

Feasibility of the reform

As a consequence of the “agency” wave of the 1990s many OECD countries have established executive agencies on arm’s length distance from the ministries. Moreover, in many countries there traditionally existed many agencies that were more or less independent, that were positioned under the umbrella of ministries and that were financed by these ministries (see Chapter 4). This is true for instance for several Anglo-Saxon countries (UK, Australia, Canada, New Zealand) but also for France and the Nordic countries. In many of these countries, governments have recently started to strengthen financial supervision on agencies, in view of increasing doubts about the effectiveness of output-steering arrangements that were inspired by the ideas of New Public Management. In France, for instance, there is currently a new wave of reforms aimed at improved

ministerial “*tutelle*” of the agencies. The Netherlands is one of the countries where this new approach has formally been adopted in government policy. The Dutch reforms are in principle applicable to all countries where arm’s length and independent agencies exist and can provide inspiration for reforms in these countries in a similar direction, leading to substantial efficiency improvements and savings.

Notes

1. For the use of the term output in this study see the glossary.
2. Sanctions may in principle take the form of budget reductions in a next budget year or of an arrangement, which specifies that budgets for services that have not been produced, must be returned (so-called after calculation).
3. In some countries, such as France and the Netherlands, some independent agencies have legal personality (public non-profit institutions in the sense of the National Accounts), but this is not the case in Sweden.
4. The expenditures for the programmes that are executed by the ministry are usually negotiated with the directorates of the core ministries that are responsible for these programmes.
5. Letter of the Minister of Finance to the Second Chamber of Parliament of 25 August 2011.
6. In a legal sense the agencies are owned by the State as a legal person. Economic ownership refers to the competence to decide on the use of the resources of the agency.

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Annex A

List of reforms

The reforms and reform trends have been categorised by chapter of the report, that is: by type of tasks and types of organisations in accordance with the snapshots and as far as support services and operational management is concerned by type of support service.

The reforms have been characterised in terms of savings and quality improvements of administration or service delivery. These savings can generally not be realised in the first year of implementations, particularly not if there are initial investment costs. In the table the savings are characterised as “moderate” (M) or “large” (L). These terms must be understood in relation to the current operational costs (compensation of employment and intermediate compensation) of the units to which they apply. A large saving on a small unit, can thus be smaller than a moderate saving on a large unit. The size of the savings is partly based on experiences and proposals in the countries where the reforms have been made or proposed, but the study has not always been able to trace such numbers, in which case the label must be seen as an informed guess by the OECD Secretariat.

Chapter	Reform	Quality improvement in		Savings
		Administration	In-kind service delivery	
3. Policy development	1. Strengthening policy development capacity within line ministries	X		
	2. Integration of executive and professional expertise in policy development	X		M
	3. Transfer of publicly funded research institutes to universities	X		M
	4. Independent fiscal forecasting institutions	X		M
	5. Whole of government standards for <i>ex post</i> evaluation	X		M
	6. Whole of government standards for Regulatory Impact Analysis and for Cost-Benefit Analysis	X		M
	7. A more consistent division of responsibilities between central and sub-central governments	X		L

Chapter	Reform	A. Quality improvement in		B. Savings
		Administration	In-kind service delivery	
4. Policy execution	1. Role of arm's length agencies	X	X	M
	2. Use of common process units	X	X	L
	3. Role of independent agencies	X		L
	4. Role of private non-profit institutions in service delivery		X	L
	5. Reform of the foreign service	X		M
5. Administrative regulation and supervision	1. Reforming economic regulation: the use of general and cross-sectoral regulation and regulators	X		M
	2. The use of independent regulatory agencies	X		
	3. Risk based supervision	X		L
6. Operational management and support services	1. Acceleration of service sharing	X		L
	2. Concentration of standard setting units for operational management	X		M
	3. Outsourcing of support services.	X		M
7. Financial management	1. Programme classification of the budget	X		
	2. Regular updating of baseline estimates	X		
	3. Medium Term Expenditure Framework	X		
	4. Focusing the budget documentation on financial information	X		M
	5. Automatic cuts of productivity dividends	X		L
	6. Strong spending review procedure, anchored in law	X		L
8. Human resource management	1. Human resources support service sharing	X		L
	2. Human resources standard setting	X		
	3. More efficient standards for pay setting	X		M
	4. Reduction or abolition of variable pay	X		M
	5. Top civil servants appointments	X		

Chapter	Reform	A. Quality improvement in		B. Savings
		Administration	In-kind service delivery	
9. ICT management	1. Improvement of ICT standards	X		
	2. Common ICT process units	X		L
	3. Gateway procedures	X		L
10. Audit management	1. Ensuring independence of Internal Audit	X		
	2. Criteria for need and size of Internal Audit			L
	3. Limit remit of Internal Audit to its core task: support of risk management			L
11 Machinery of government	1. Contain the number of ministers	X		L
	2. Minimise the number of deputy ministers and other political officials	X		L
	3. Strictly limit the number of political advisors to ministers	X		M
	4. Simplify cabinet committee structures	X		M
12 Steering of agencies	1. Output steering in agencies	X	X	M
	2. Financing of agencies	X	X	M
	3. More professional ownership of agencies	X	X	M

Glossary¹

Agency: unit of a ministry with a separate financial administration.

Administrative employee: every employee of general government (in the sense of the national accounts) except employees tasked with service delivery in kind*.

Administrative expenditure: operational expenditure* of administrative unit* (and administrative investment²).

Administrative investment: gross capital formation for accommodation and equipment of administrative unit*.

Administrative unit: government unit consisting of administrative employees*.

Administrative regulation: Economic regulation*, financial regulation* or social regulation* by authorities other than the formal legislature.

Administrative services: application of administrative regulations* in individual cases.

Administrative supervision: Monitoring of compliance with laws and administrative regulations* other than through the regular police, in particular through inspectorates.

Arm's length agency: agency* for which the minister is responsible as far as (executive) policy is concerned (not necessarily for the handling of individual cases). The minister remains also responsible for operational management.

Base line estimates: multi-annual estimates of expenditures on the basis of current policy at the level of line items*.

Central ministry: Prime Minister's Office, Ministry of Finance and ministry where the most important tasks in the area of standard setting* for operational management* are located.

Civil service: all employees of central government whose labour conditions are ruled by public law.

Common process unit: government unit that carries out tasks that belong to the primary process of more than a single ministry of central government or more than a single government (for instance a ministry and a municipality).

Core ministry: the part of the ministry that is not organised in agencies*.

Division of a ministry: unit of a core ministry led by an official who reports directly to the minister or deputy minister or to the permanent secretary*. National titles of officials leading ministerial divisions may be: Director-General, Director, Assistant-Secretary.

Economic (or "market") regulation: regulation of entry to or exit from a market, the prices at which goods and services can be sold or the quantities of goods that can be sold. Economic regulation also includes regulation requiring the provision of access to infrastructure owned by other parties.

Executive policy: policy concerning policy execution.

Financial instrument: tax, grant, subsidy, social benefit.

Financial regulation: regulation concerning financial instruments*.

Horizontal integration: process sharing among agencies* and merging of agencies*; sharing of support services* or merging of support service* units.

Independent agency: agency* for which the minister is not responsible, nor for executive policy*, nor for the handling of individual cases (the minister remains responsible for policy and operational management*).

In-kind service delivery employee: every employee in the military, the police, the penitentiary institutions, units providing other collective services in kind (for instance construction or maintenance of transport infrastructure: roads, tunnels, bridges, waterways, harbours, rail networks, airports, pipelines, etc., or ICT infrastructure), non-profit institutions classified inside general government in the national accounts, educational institutions, health providers and units providing other individual services in kind (cultural institutions, institutions providing social services, etc.).

In-kind service delivery unit: government unit consisting of in-kind service delivery employees*.

Input: human resources, procured goods, financial resources, non-financial assets.

Line item: authorised expenditure at the most detailed level of the classification used in the annual budget law.

Line minister: minister who is not responsible for standard setting for operational management (or acting in other capacity than that).

Market structure: conditions of the market that determine its competitiveness. A market can be imperfect because of small numbers of buyers or sellers (monopoly, oligopoly), information asymmetry, or external effects. Monopoly or oligopoly can be legal (legal entry barriers) or natural (decreasing marginal costs for instance in network services).

Operational management: decision-making on the use of operational means*. For instance: financial management, human resource management, procurement management.

Operational (or technical) efficiency: relative productivity of a production process compared to the optimal production process with the same output.

Operational expenditures: expenditures for compensation of employees and intermediate production (in the sense of the national accounts).

Operational means: communication, human resources and organisation, internal audit, procurement, information and ICT, finance (budgeting, accounting and cash and debt operations), accommodation, real estate and facilities (office equipment, reproduction, cars, catering, security, cleaning, internal post).

Output: Services in kind* and administrative services*.

Out-year: each year of the multi-annual estimates after the (upcoming) budget year.

Permanent Secretary: highest civil servant of a ministry. National title is often: Secretary General or permanent secretary.

Planning bureau: unit of the government that provides forecasts on economic, social, financial and environmental developments and scenario studies on impacts of government

policies on those developments. A planning bureau may in addition provide other forms of policy analysis.

Policy evaluation: assessment of the effectiveness and efficiency of a policy (in terms of targets and instruments).

Private corporation: institutional unit belonging to the corporate sector of the economy (in the sense of the national accounts) which is not controlled by the government.

Programme expenditure: all expenditure except administrative expenditure*.

Programme investment: gross capital formation other than administrative investment*.

Public corporation: institutional unit belonging to the corporate sector of the economy (in the sense of the national accounts) which is controlled by the government.

Public non-profit institution: Non-profit institution with legal personality, controlled by government.

Senior Civil Service: top layer of the civil service*.

Services in kind: individual and collective goods provided to citizens and legal persons.

Social regulation: regulation of the quality of goods and services that are sold on markets or that are provided by government outside markets (against “insignificant prices” in the sense of the national accounts). This includes, for example, regulation of environmental quality, food safety, labour conditions and regulation of the quality of health care and of education.

Standard setting: adopting rules on operational management*.

Shared service centre: government unit that provides support services* to more than a single ministry of central government or to more than a single government (for instance a ministry and a municipality).

State: legal person headed by the government.

State government: sub-sector of general government between central and local government that characterises federal states.

Sub-central government: sub-sectors of general government other than social security and central government (State government* and local government).

Support services: services to support operational management*.

Vertical integration: a better use of executive and professional expertise in policy development.

Notes

1. Terms provided with a * are defined elsewhere in the glossary.
2. In practice administrative investment is often not counted as administrative but as programme expenditure.

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Value for Money in Government

Building on Basics

Contents

- Chapter 1. Introduction
- Chapter 2. Statistics
- Chapter 3. Policy development
- Chapter 4. Policy execution
- Chapter 5. Administrative regulation and supervision
- Chapter 6. Support services and operational management
- Chapter 7. Financial management
- Chapter 8. Human resource management
- Chapter 9. ICT management
- Chapter 10. Internal audit management
- Chapter 11. The machinery of government
- Chapter 12. Steering of agencies

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