

Public Sector Modernisation: Changing Organisational Structures

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Introduction

Governments have always changed their structures to respond to new priorities in a changing society, or to improve the management of existing ones. They have also taken advantage of new capacities and better governance in society in general to put some of the functions previously performed in the core public service at arm's length, or even to privatise or contract them out.

One of the biggest influences on structures of government in recent years has been the privatisation of state assets. Over the past two decades, privatisation in OECD countries has raised in excess of three-quarters of a trillion dollars (USD). Manufacturing and banking have led the privatisation process, followed by the non-competitive and infrastructure sectors of the economy such as water or public transport services. Over the past 10 years, telecommunications sales have been the largest source of privatisation revenue in OECD countries. Since 2000, however, privatisation activity has slowed with the economic downturn and the diminishing inventory of assets for sale in the larger countries.

Other structural changes of a lesser scale have involved creating new ministries or sub-ministries, merging ministries or departments, or disbanding them. As society has become more complex and changes occur more rapidly, governments have had to undergo this form of change more often, but most of it has been in the form of small-scale reforms that do not fundamentally affect the way governments work. The overall governance structure has usually remained the same.

But over the past two decades, some OECD member countries have moved beyond simply adapting their organisational structures to new circumstances and have started to use change deliberately as a method of reforming performance and values within

This Policy Brief is the third in a series looking at the evolving modernisation agenda and how governments can best adapt their public sectors to the changing needs of their society. The first Policy Brief in the series, Public Sector Modernisation, takes an overall view of the issue and other Briefs deal in more detail with individual aspects of modernisation, such as Governing for Performance.

government across the board. This includes everything from changing the size of the cabinet and the number of government ministries to creating bodies at arm's length from core ministries and setting up independent regulatory agencies (IRAs).

Are these new structural changes within government achieving the desired result? And if not, what can governments do to make them more effective? This Policy Brief looks at current trends in how governments organise themselves, the likely impact of such changes, and how to develop better ways of making policy choices in this area. ■

Why do governments change their work structures?

Most government re-organisations respond to immediate concerns, both internal and external. Internal reasons can be political – rewarding a politician with a larger ministry, increasing the size of the cabinet – or aimed at improving general management processes and culture by splitting or merging ministries or separating policy making from policy implementation.

External pressures can come from the emergence of a new policy priority, as was the case following the 11 September 2001 attack on the United States. That event led to proposals for a new national Department of Homeland Security and a new organisation to take charge of airport security. This illustrates a wider tendency in governments: when confronted by a threat to security, they tend to re-centralise authority.

Organisational change can also be used to signal political intent to address a problem, without guaranteeing that anything else will be done. And in some cases re-organisation is used as a substitute for making hard choices about management and priorities. Creating an agency and labelling its work a priority does not automatically mean it will be treated as such.

In the longer term, a number of underlying social trends influence the way governments organise how they work. These include:

Diversification: The move towards measuring and controlling output, rather than input and processes, increases the tendency towards organisational diversity. Some governments have taken the view that as long as outputs can be controlled, it matters less what kind of organisation does the production.

Specialisation: There is an increasing need for specialised skills as society and government become more

complex, and as governments are required to provide more individualised services to citizens.

Incentives: There is a new tendency to apply to government organisations the thinking derived from economics on the way incentives of different kinds influence people's behaviour. This has meant that attempts to change the public service culture increasingly include organisational change.

Confidence building: Modern governments need to ensure that the public has confidence in the decisions they make. As communication becomes increasingly important, announcing a new organisational structure has strong symbolic value. Governments can also use new structures to “tie their own hands” by setting up an organisation in such a way that it will be difficult for governments to change it. This creates confidence in the durability of the policies represented by the structure. Credibility has also become a crucial resource for policy makers at the national level, and increasingly it comes from persuasion rather than coercion.

Accountability: The tendency for governments to move from controlling processes to controlling performance is increasingly seen as possible only if an individual can be held responsible and accountable for such performance and his or her incentives modified accordingly. This trend away from the “faceless bureaucrat” and towards more personal accountability appears to create a preference for organisational structures that facilitate such accountability. ■

How many ministries?

The number of government ministries and their structures change constantly. Most newly-elected governments shake up the cabinet structure and the number of ministries. But overall, the size and number of ministries in OECD countries grew rapidly from 1950, then stabilised in the mid-1980s and has since even decreased in some sectors of the economy. Today, most OECD countries have a cabinet or council of ministers of between 15 and 20 ministers. While the core cabinet has been kept quite small, most OECD countries have adopted a model where cabinet ministers are supported in some areas by junior ministers or secretaries of state.

This stabilisation of the number of cabinet ministers is not surprising, as any extreme reform in cabinet size will necessarily open up some new governance weaknesses. While a small cabinet may be more manageable and efficient, it may also risk tyranny. A larger

group may offer broad representation of a full range of interests, but may be unable to take clear decisions.

In general, a well-functioning large cabinet will require a strong political and administrative centre, a well-developed sub-committee system, and standardised bureaucratic processes and structures across ministries, while a smaller cabinet will require well-functioning competitive mechanisms for budgeting and funding.

As well as an increasing similarity in cabinet size, OECD countries have also converged in the overall governance structure of their cabinets. With the exception of New Zealand, for example, individual ministries have only one representative in cabinet, and generally there are strong similarities in decision-making processes.

Within the framework of a stabilised cabinet model and size, it is impossible to draw general conclusions on whether large organisations are better than small organisations or the other way around. It depends on the nature of the functions, the wider institutional setting, the management goals one is trying to achieve, and the culture of the organisation.

In general, however, smaller organisations offer tighter focus and clearer accountability, but make collectivity harder. Larger organisations can offer economies of scale and can merge ill-functioning units into well-functioning ones, but may take decisions internally which should be addressed politically. ■

Who picks the time for change?

The intensity and frequency of these kinds of change to organisational structures vary greatly among countries, but one thing is clear: re-organisations are more frequent in the period following an election.

Core ministries in charge of sovereign functions of government such as defence, finance, and foreign affairs are less likely to be re-organised, along with core departments indispensable to the functioning of government such as cabinet offices and budget offices. This is not surprising as the costs and dangers of such re-organisations for the overall functioning of government might be too important compared to the possible gains. It may also be that such bodies — which are themselves the movers of change — may be less disposed to make themselves the objects of reform.

On the other hand, the areas more likely to undergo institutional re-organisation include those that deal with the principal interests of the community, such as

farming, fishing, mining, tourism, industry and social welfare. Some analysts see the recasting of institutional combinations as the result of the influence of interest groups. There is little doubt that pressures from lobby groups, especially those linked to a political party, influence the choice of organisational forms as governments might choose to favour “visible” changes to organisational structures. A report by the State Services Commission in New Zealand points to the uneven influence that “population” ministries (ministries for women, Pacific peoples, young people, etc.) have had on the direction of policy decisions. Although the report recognises that these groups would not have been as well represented without their ministries, it is possible that other means of mainstreaming the priority on these groups within government could have been used to better effect. ■

Why create new ministries?

Governments may create new ministries from scratch, or by separating one ministry into two or more separate bodies. Each change raises its own type of challenge.

Often a government creates a new ministry, or state secretariat within a ministry, as a way of signalling a new policy priority, as has been the case with women’s affairs and the environment in recent years. Most countries have established specific environmental ministries since the 1970s. These new structures allow the creation of capacity in a new government policy area and provide an opportunity to bring new people into government, particularly those with expertise in the specific area. But the risk for such new structures is that they will remain marginalised within government, headed by relatively junior ministers and having a weak bargaining position.

But new government priorities do not always mean the creation of special new ministries to deal with them. In some cases, those responsible for a new issue are given some kind of independent or autonomous status, while others are integrated into formerly existing ministries.

And there are an increasing number of new policy priorities that cut across all sectors of government, such as sustainable development or regional development. Such priorities, which require a lot of co-ordination among existing ministries, do not lend themselves to being dealt with by a separate functional body. Few OECD countries have set up specific ministries for these issues, preferring what are essentially co-ordination processes although of many different types. ■

Creating arm's length bodies: a lever for reform?

Traditionally, in most OECD countries, core government is defined as the ministries and departments of the executive, under the direct hierarchical control of a minister or of the head of state in presidential systems. These direct accountability lines provide a simple and stable governance model in which policy making and the delivery of services fall under the responsibility of a government clearly accountable to parliament and ultimately to the people. The same set of financial and management laws and reporting mechanisms generally applies to all of these bodies.

In the past two decades, this picture has been significantly altered by distributing government responsibilities to bodies at arm's length from the control of politicians, with different hierarchical structures from traditionally functioning ministries and in some cases management autonomy or independence from political influence.

The reasons for creating these bodies have been twofold: to make the system more efficient and effective, or, depending on the type of body, to legitimise decision making by providing some independence from direct political intervention.

There is no universally accepted classification of arm's length bodies, which differ widely in terms of organisation, legal status, and degree of management autonomy or political independence. But basically governments have used three main methods to distance these bodies from core ministries.

The first method is a different governance structure and hierarchy from a traditional ministry. The second is a different control environment, in other words partial or complete exemption from managerial, financial, and personnel rules that usually apply to traditional ministries. And the third is a degree of management autonomy. In the absence of a commonly agreed term for this phenomenon, the OECD has coined the label "distributed governance".

These arm's length bodies in central government now account for between 50% and 75% of public expenditure and public employment in many OECD countries. This new institutional environment has created new challenges for governments to maintain central direction and control.

Over the past 20 years, three major trends have influenced the distribution of power to arm's length bodies: increased managerial autonomy for some government bodies; the arrival of new agencies; and the creation of regulatory bodies. ■

Core Federal Government in the United States

In the United States, "agency" is a term and concept defined and employed generically to refer to all executive branch entities.

The United States cabinet is not a body with collective responsibility. It is an institution whose existence rests on custom rather than law. There are presently 14 departments in the executive branch, the heads of which serve in the cabinet. Recent presidents have exercised their prerogative to invite others to attend meetings and have "cabinet rank". Also, presidents, recognising the limitations inherent in the institutionalised cabinet, have long sought alternative ways to provide themselves with advice and political support. In the post World War II period, sub-cabinet groups such as the National Security Council were established, and other councils have been established from time to time with membership of departmental secretaries and others.

Although the cabinet is formally the body closest to the president, in practice there is general agreement that the president relies most heavily upon his immediate staff offices and officers, the Executive Office of the President. It consists today of the White House Office and approximately 14 additional offices reporting directly to the president. They include the Office of Management and Budget (OMB), the National Security Council, the Office of the Special Trade Representative, the Office of Administration, the Office of National Drug Control Policy, and the Council of Economic Advisors.

In addition to departments and the Executive Office of the President, there are approximately 60 "independent agencies". This term refers to an agency outside of an executive department. Independent agencies are regular agencies of government subject to all the same laws as are agencies within executive departments, except where individually exempted. The heads of independent agencies report directly to the president. In practice, however, presidents rarely spend time or resources managing the independent agencies, leaving such matters principally to budget examiners in the OMB.

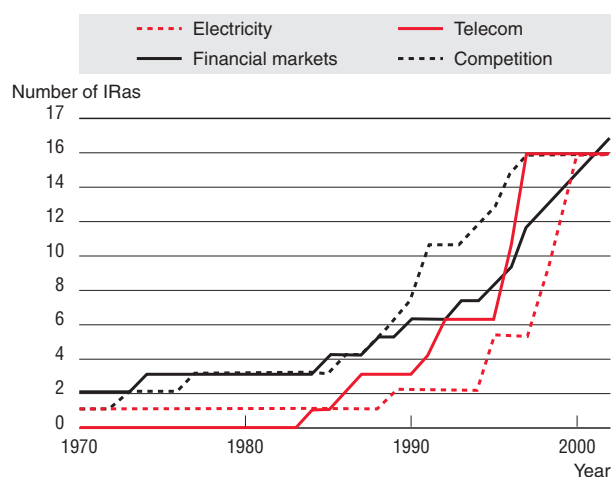
Source: Excerpts from a case study written by Ronald C. Moe, in *Distributed Public Governance*, OECD, 2002.

Many countries have had central government bodies that are separate from traditionally structured ministries or departments and to which different financial and human resources management rules apply. In some countries, these bodies are a separate legal entity; in others they are just institutionally separate. Most of these long-standing bodies have been created over time, some for political reasons and others for more managerial purposes. Some function mostly under public law (examples include the “*établissements publics administratifs*” in France, “indirect public administration” in Germany, many Crown entities in New Zealand, the long-standing “agencies” in Sweden, some of the “non departmental public bodies” in the United Kingdom) while others function mostly under private law (public enterprises, quasi public enterprises). In recent years, however, these bodies have been given additional managerial autonomy through contractual arrangements with their parent ministries, output/outcome oriented management and multi-year budgeting.

A number of governments have recently created what may be called “agencies”. These are bodies that remain ministerial bodies in most cases, and are thus not separate entities. They are managed under clear contractual arrangements within the reporting hierarchy and benefit from a high degree of relaxation of their input controls. They have specifically been used for delivering services as governments, under pressure to increasingly focus on performance, have felt the need to better focus the individual accountability of staff and of the organisations themselves. The scope of these reforms varies significantly. The United Kingdom has created 131 departmental agencies since 1988, employing more than three-quarters of the civil service. In the Netherlands, it is expected that by 2004, 80% of the civil service will be working in departmental agencies. Other more limited reforms, such as the *centres de responsabilité* in France or the performance-based organisation programme in the United States, have concerned a more limited number of organisations. Important reforms were also carried out for example in Korea, where 23 departmental agencies have been created since 1999 that now employ more than 5 000 staff and account for 7% of the government budget.

The number of independent regulators, with delegated powers to implement specific policies, has also increased significantly across OECD countries. This trend has accompanied the deregulation and privatisation process experienced in OECD countries since

Figure 1. IRAs in economic regulation



Note: Data cover members of the European Union plus Norway and Switzerland.

Source: Gilardi (2003): *Spurious and Symbolic Diffusion of Independent Regulatory Agencies in Western Europe*.

the early 1970s. Many countries have set up or are establishing new market-oriented regulatory arrangements for utilities such as electricity and water and for telecommunications, financial services, or the social and environmental area. ■

How successful are arm's length bodies?

In the case of bodies functioning with some managerial autonomy, various internal government studies point to improved efficiency and effectiveness or to major cultural change. The latest UK report says the government has achieved “revolutionary changes” in the culture, process and accountability of services directly delivered by central government, as well as “genuine improvements in customer service and an increased focus on results and business planning.” In 2002, a Dutch government evaluation of its new agency model concluded that the agency form does contribute to improving efficiency.

It is also significant that, over the past 50 years, only a few autonomous bodies have been brought back under the core traditional hierarchy. Many countries are trying different organisational forms to find the best institutional features to fit their own needs, but the idea that some important parts of core government should be at arm's length is not called into

question. What is now at the centre of the debate is what institutional features give the best balance between autonomy and control.

As for independent regulators, a recent OECD study has shown that the independent regulator is a highly regarded institutional option in modern regulatory governance and, at least in countries with a well-ordered marketplace, is now considered a better alternative to the use of line ministries for this purpose. Independent regulators have been used for many years in Canada and the United States, but historically have been much less common elsewhere. This type of institutional structure has now been taken up by a wider range of countries. Evidence has now shown that regulatory reform has been instrumental in promoting efficiency through competition and in improving transparency and accountability of government interventions, by separating ownership and regulatory powers and by delegating the implementation and enforcement of regulatory powers to regulatory institutions at arm's length from day-to-day government activities. ■

What are the new governance challenges?

There is mounting evidence that OECD countries that have delegated a lot of responsibility to arm's length bodies are rethinking the challenges this creates. So far they have reported the following main problems which have arisen as a result of distributed governance:

- The large number of new organisational forms and governance structures, management regimes and reporting mechanisms has resulted in a blurred picture of how the system is functioning. Ministries are having to adapt their steering and control mechanisms to too many different types of bodies. This weakens overall control by parliament and may damage citizens' confidence and trust in the system because it is too complicated to understand.
- Delegating responsibilities to arm's length bodies has led to difficulties in co-ordinating government work. Government coherence suffers from a lack of co-ordination in the definition of objectives, but also in the way government functions to perform these objectives. The lack of co-ordination may also eventually result in overlaps and duplication of work. This will be all the more damaging as arm's length

organisations are more difficult to restructure than classic units within ministries.

- Perhaps more importantly, distributed governance has inherent risks for democratic control and accountability. When bodies are removed from immediate supervision and have a more complex governance structure involving other stakeholders than their parent ministries, political control of these bodies may suffer. Without adequate steering, arm's length bodies may follow policies that favour their own interests and are not responsive to policy needs. In addition, output/outcome budget and management rules require that reporting bodies have very strong capacities in these fields, for which they remain unprepared in a large number of cases. In addition to the risks of undiagnosed non performance, this may also eventually result in increased corruption.

Not all of these risks, however, apply to all types of arm's length organisations. They vary significantly with the different institutional features.

It is possible to draw conclusions from OECD countries' experience as to the basic conditions for a successful and sustainable distributed governance system for most of them. These conditions include a sound legal and institutional framework that would limit the number of types of arm's length bodies, give them a clear legal basis and justify any exceptions to the stated rules. A well-thought-through structure for individual institutions is also important, including a gradual move to arm's length systems. Not all bodies will be ready at the same time to function at arm's length from government, not least because governments need to make sure they have enough managers available to work at arm's length in an outcome-based environment. This is especially an issue in relatively small countries.

One problem is that the ministries that are responsible for monitoring the arm's length bodies may be slower to adapt to performance-based management than the newly-created organisations, and dealing with this is a key challenge in establishing a well-functioning distributed governance system.

In any case, building capacity takes time. It takes months, and often years, to transform part of a traditional ministry hierarchy into an arm's length body that functions well, and for the supervisory ministry to be able to steer it well. The process of getting things right cannot be entirely driven by the top but depends on co-operation and learning from both parties. ■

What have we learned so far?

- Because other institutions in society are changing more quickly than in the past, structural change in government is also becoming more frequent, even if the size and number of privatisations — the major change in government organisation over the past two decades — have decreased recently. If there is continuation of the current tendency to use structural change as a lever for management change and as a political signal, then the trend for structural change in government will accelerate.
- Most OECD countries have been creating non-commercial bodies outside the core public service on an *ad hoc* basis, resulting in an administrative “zoo”. This reduces the transparency of government for the citizen, and may compromise oversight and accountability within government. A few OECD countries have addressed this problem with umbrella legislation that defines the options for different organisational structures within the public sector and creates standards for their governance.
- Structural change can be a powerful lever for reform but it can also be risky. The political benefits of signalling change through re-organisation tend to come at the beginning, and the real costs later. Re-organisations distract staff attention, increase staff insecurity, and distract management attention from immediate challenges. If major staff changes occur, there can be major costs due to the time necessary to make new appointments, and there are also risks associated with the loss of institutional memory, networks, and values.
- The consequences of structural change sometimes go beyond their original intent and may influence not only the decision-making process and management culture of the organisation concerned, but also the whole government decision-making process. So governments must be aware of the direct and indirect costs when adapting the machinery of government to changing national circumstances, and of the alternatives to re-organisation. It is thus important to ensure that the threshold for creating new organisations is high, that the requirements for different kinds of organisational form are spelled out in legislation in many cases, and that other alternatives for solving the problem are fully considered. Alternatives to structural changes include improving decision-making processes, performance

management, accountability and control, programme design, administrative and financial processes, level of resources, and leadership.

- The politically-driven trends of merging and separating public sector functions as ministerial portfolios are changed by policy and political considerations seem likely to intensify because they have become part of government’s armoury of public persuasion. If the civil service is to be able to adjust to these changes without unnecessary loss of capacity to serve the government and the public, it is important that senior public servants be able to move to different functions within the organisation and that there be a whole-of-government culture that transcends the diversification in individual ministries and departments.
- It is also important to remember that changes to organisational structures do not, of themselves, ensure management changes. For example, separating ministries into different entities cannot in itself create more focus or more management if other incentives are not established. Achieving the purposes of changes to structures requires good leaders driving a determined process of aligning policies, procedures and ultimately the hearts and minds of staff with the wider government purpose.
- Wholesale “agencification” within the public sector has been used in recent times with considerable success in three OECD countries — the Netherlands, New Zealand and the United Kingdom. It has a much longer history in Scandinavia, particularly in Sweden. There are two very important points to note. First there are very big differences in how these countries have set up and managed these more independent bodies. Second, their success has been highly dependent on the nature of the wider political and administrative culture in which they are imbedded. The same organisational structures in a different institutional setting will produce different results. ■

For further information

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For further reading

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