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HAND-OUT

BUILDING ON BASICS

OECD VALUE FOR MONEY STUDY, FINAL REPORT

Sections from Chapter 1 -- Introduction on new trends in public administration

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Sections from chapter 1 Introduction on new trends in public administration:

1. Three periods of public administration
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3. Building on Basics

1. Three periods of public administration

1. In many OECD countries, and in particular in the Value for Money countries, three periods of public administration reforms can be distinguished since the 80ies of the previous century: those of receding government (1980-1990), New Public Management (1990- 2005), and the current period (from 2005).

2. The period of receding government is commonly associated with the Reagan administration in the USA and the Thatcher Cabinet in the UK, but there were many governments in other OECD countries that subscribed to similar ideas and programmes. 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 too high tax and expenditure levels. A popular saying of the period was that “government is the problem, not the solution”. Theoretical underpinnings of these ideas were partly found in supply side economics and partly in public choice economics. Supply side economics showed that essential incentives for growth in the private sector could be impaired by too high levels of taxation, public choice theory showed that without strong constitutional and legal constraints, the incentives motivating bureaucratic and political behaviour, would lead to ever expanding public sector that would eventually overwhelm the private sector of the economy.

3. During the nineties of the previous century the organisation of government has been profoundly influenced in all countries participating in the Value for Money Study by the ideas of New Public Management. These ideas have partly been proposed and promoted by governmental commissions and task forces and partly by academics in the field of public administration.

4. 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 80-ies and 90-ies of the previous century to participate in high level committees that had to advise governments on organisational reform. These consultants brought primarily 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 sixties and seventies) become prominent in academic circles.

5. The ideas of New Public Management have been described in many reports and publications with certain variations but a solid core. The core includes:

- a. Separation of policy execution from policy development;
- b. Stimulating competition among service providers, by allowing private suppliers to provide collectively funded services and through demand financing (consumer subsidies and vouchers);
- c. Loosening of standards of operational management both in policy development and policy execution (“let managers manage”);
- d. Steering and control of executive agencies on the basis of output targets;
- e. Budgeting on the basis of output targets (performance budgeting);
- f. Outsourcing of intermediate production for both core ministries and executive agencies to the market.

6. Some of New Public Management reforms have without doubt been successful and have been adopted in many OECD countries. Splitting policy execution from policy development, has made the core of government much smaller and easier to steer. Furthermore it has focused attention on the separate set of competencies and facilities that are required to run an executive organisation in efficient way. Competition among service providers has generally increased quality of services and efficiency of service delivery and can generally be seen as a success where it occurred. Reclassification of the budget on the basis of output areas has generally led to a reduction of the number of line items and better transparency. Outsourcing has sometimes led to lower costs and better quality of intermediate products, especially in cases where public demand did not require specific assets.

7. However, other New Public Management reforms have led to unexpected results such as undesired growth of support services and administrative executive agencies, loss of service quality for citizens and business in many areas of service delivery, demotivation of professionals in service delivery (care providers, teachers, police officials, etc.), accumulation of public funds in agencies outside the control of ministers and loss of control of the centre of government for service delivery (Office of the Prime Minister and the ministries responsible for finance and operational management). It is impossible to prove, but it cannot be excluded that the loss of trust in government among citizens and the business community that has occurred in recent years in many OECD countries is connected with the New Public Management reforms.

8. Currently, 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. Some of these trends can be described as “more front office, less back office” or as the Danes say: “more warm hands, less cold hands”. Although it is still early, it is possible to discern already some common features of the reforms that are currently undertaken. These include;

- Reallocation of public resources from administration to service delivery;
- Better integration of executive and professional expertise in policy making;
- Amalgamation of executive agencies or establishment of common process units;
- Support service sharing among ministries and executive agencies;
- More emphasis on standards of operational management in all areas: finance, audit, procurement, accommodation, real estate and facilities, human resources and organisation,

communication, information and ICT; application of standards across central government, also in executive agencies;

- Concentration of standard setting for operational management in one or a few ministries;
- Separation of financing of agencies from steering and control of outputs;
- Steering and control of outputs through a permanent performance dialogue rather than on the basis of output indicators;
- Reduction of output and outcome information in the budget documentation;
- More emphasis on meeting the preferences of individual citizen's by greater variety of public supply and tailor made solutions for individual citizens and businesses.

Some of these new trends are based on ICT, and have only become possible because of ICT development.

9. In order to understand better the current reforms and the implied swing back from some of the New Public Management reforms, it is useful to shortly review the problems that many countries have encountered while implementing these reforms.

2. Problems with New Public Management

10. Some countries have gone further than others in reforming their governments along the lines of New Public Management. Among the ones that have gone the furthest are New Zealand, Australia, the UK and the Netherlands. These countries have also most experience with the problems flowing from these reforms. These problems can be summarised as follows.

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

11. 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 regulation that is impossible to execute or that give rise to unexpected problems during execution. Furthermore, whatever the autonomy of agencies in operational management and handling of individual cases, a line minister cannot bear responsibility for sectoral policy vis-à-vis parliament and society at large without a firm grip on the principles of execution (executive policy).

Loosening of standards of operational management has led to cost increases

12. 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 anarchy, 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.). Too loose operational standards lead to cost

increases all over government and in particular 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.

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

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

- a. Outputs are difficult to measure.
- b. Output definitions are subject to permanent reformulation.
- c. What has to happen if output targets are not achieved?

14. *Ad a.* The main difficulty with the measurement of outputs is the heterogeneity of services. 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 agency managers, and, more importantly, of the professionals in the police, the care sector, the schools, the army, 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.

15. *Ad b* 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 or educational level, 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.

16. *Ad c.* 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.

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

17. 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 put on the footing of output measurement (performance budgeting). The underlying reasoning was that politicians have to compete in the budget process for the priority of their outputs with other ministers. This process could only proceed rationally if the budget process was based on information on outputs (current outputs and claims for new outputs) and cost-prices for outputs. This philosophy has led in many OECD countries to far reaching reforms. The budget documentation was packed with output information, input information was removed, expertise on inputs (employment, salaries, procurement, external consultants, accommodation, ICT, etc.) in ministries of Finance and other ministries responsible for operational management, was neglected or abolished, expenditure divisions of ministries of finance were reduced.

18. The difficulty with these reforms 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. But there is also a more basic problem. These reforms were overrating the capacity of the budget process. The budget process was deemed to be the central planning mechanism of the government. However, more than 90 percent 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 cabinet agreements on the proposal of line ministers, or in presidential systems in presidential decrees on the proposal of line ministers, or in multi-party systems in coalition programmes, entirely independently from the budget process. Line ministers are responsible for these laws and policies vis-à-vis parliament and society at large. Obviously line ministers need output and outcome information in order to develop and execute their programmes. Similarly, parliamentarians need such information to hold line ministers to account. Accordingly, this information should be a normal component of the regular exchange between line ministers and parliament. 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 are obviously 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 planning mechanism of the government may lead to the neglect of its more basic role in the maintenance of budgetary discipline.

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

19. 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 can not be used in sales to other customers, he must charge the full cost of these assets to the first product 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 have often 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.

3. Building on Basics

20. When overseeing recent developments, one can observe in a part of the countries participating in the Value for Money project a distinct swing back from the New Public Management reforms. This is particularly true for most of the lead countries of the project (Australia, Denmark, the Netherlands, Sweden). These countries have reintroduced or strengthened some of the basic institutional arrangements that were abandoned or reduced in the New Public Management era. One can think of rebuilding executive and professional expertise in policy development units of line ministries, centralisation of support services within ministries including their agencies, stricter standards for operational management in ministerial divisions and agencies, build up or restoration of databases and expertise in ministries responsible for finance and operational management.

21. However, new trends cannot simply be described as back to basics. They are also distinctively new trends. These trends have to do with the development of ICT, which opens new and exciting opportunities for improvement of service quality and ease of communication with the government, and with more tailor made service provision to citizens and businesses. ICT has the potential for improving service quality because it can make available to executive officials and professionals better and more timely information they need for their work in education, health, the police, defence, etc. Furthermore, e-government has the potential for an enormous simplification of the ways citizens and businesses can communicate with the government about the services that are relevant to them. Partly as a consequence of the potential of ICT, but also independently from that, there is a distinct trend to more individualised service provision and more individual choice. Under this heading one can subsume decentralisation of service provision to sub-national levels of government which are closer to the immediate living environment of the citizen and more emphasis on choice of services and service providers in areas such as health, education and social services. More individual choice can be realised by allowing larger variety

of supply by more autonomous service providers (schools, hospitals, social service providers) and by financing demand (through consumer subsidies and vouchers), rather than supply (through producer subsidies). In this light the OECD Secretariat has chosen to describe the current developments in public administration under the heading of Building on Basics.

22. The development of ICT is not only important because of its potential for the improvement of service quality and expansion of choice for citizens and businesses, but also because of its potential to generate large savings. Savings are possible through automatization of information processing, large economies of scale and electronic communication (e-government). ICT has already thoroughly changed the nature of public administration and will continue to do so in the coming years.