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MARKET-TYPE MECHANISMS SERIES NO. 6
INTERNAL MARKETS

OVERVIEW, DENMARK, IRELAND, UNITED KINGDOM BY PAUL BYRNE
AUSTRALIA BY JOHN MELLORS

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT
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At its first meeting in June 1990, the new Public Management Committee of the OECD (known as PUMA) launched a study into the fair and effective use of market-type mechanisms in the public sector. The programme focuses on a range of mechanisms which can be used to incorporate some elements of the market into the delivery of public services. Chiefly conducted under the supervision of the group of Senior Budget Officials of Member countries, the programme’s final report was approved by the PUMA Committee in the spring of 1993 and will be published in the Autumn.

In embarking on this programme, the PUMA Committee was responding to two related considerations. First, more extensive use of market-type mechanisms appears to offer one avenue of responding to the pressure to restrain public expenditures, which remains strong despite a decade of severe budgetary restraint and a marked slow-down in the rate of growth of public expenditures. Market-type mechanisms may provide a means of modernising public sector management, and of improving the capacity to reallocate resources in line with emerging priorities, as well as of controlling public expenditure. These aspirations were reflected in the OECD Ministerial communiques of 1989 and 1990.

Second, there are gaps in knowledge about market-type mechanisms. While privatisation has been extensively practised and studied in recent years, less is known about the mechanisms which fall between privatisation and traditional public sector delivery. This arises from the fact that they comprise a wide array of techniques ranging from well known instruments such as user charges and contracting-out to more novel approaches such as the modification of property rights in common goods (fisheries, radio spectrum) or new incentives and management structures in complex fields like health services. Moreover, within the OECD, national experiences in the extent and depth of use of market-type mechanisms vary widely. The lessons from these varied experiences are not yet clearly formulated, nor widely disseminated.

Consequently, PUMA’s work programme is designed to assess how, and to what extent, market-type mechanisms can contribute to improved public sector efficiency and effectiveness, not only in furthering productivity and cost control but also in improving flexibility and capacity to change. In addition, since the use of these instruments as an alternative to traditional delivery of public services has raised concerns about equity, this dimension is being fully incorporated into the studies.

The aim of the present series of occasional papers on market-type mechanisms is to disseminate preliminary results and to make available some of the background papers and study reports prepared for the programme. Given the size of the programme, it is not possible to explicitly include all of the material produced in the final report, but the quality and timeliness of many individual contributions warrant a wide distribution.
The papers comprising this series were selected for their interest and relevance to current public management concerns. The market-type mechanisms programme is led by François Lacasse of the Public Management Service who is also the editor of the series. Alison McGlynn directed the early stages of the work on internal markets.

The papers are published on the responsibility of the Secretary-General, the views expressed are strictly the authors' and do not necessarily reflect those of the OECD or the governments of countries where the information was collected.

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INTERNAL MARKETS FOR THE PROVISION OF GOODS AND SERVICES FOR USE BY CENTRAL ADMINISTRATIONS

by Paul Byrne
BACKGROUND

Since the early 1980s, there has been a concerted drive in many OECD Member countries to change both the organisational structure of, and the management practices applying in, central government institutions. Underpinning this movement has been the concern that central government bodies may not have been giving the taxpayer value for money -- or at least that existing arrangements did not allow this concern to be tested in any objective manner. While the reforms initiated have varied from country to country, both as to their component elements and the extent to which they have been applied, there are several elements which are found to be common to virtually all such reform programmes:

-- a more concentrated focus on the setting of objectives and the measurement of results with a consequential increase in both personal and corporate accountability;

-- emphasis on the need to measure accurately all input costs associated with the delivery of each service;

-- greater flexibility in the management of resources, both financial (fewer, less specific appropriations, delegation of decision making to lower levels of operation, some end-year flexibility and so on) and personnel (control of numbers of staff, classification etc.); and

-- an acknowledgement that many of the traditional distinctions between the services provided by central government and those supplied by the private sector are frequently somewhat artificial in that both are supplying the needs of a market and the consequential adoption by central government agencies of certain commercial practices and principles in relation to charging and competition.

Traditional bureaucratic and control mechanisms and attitudes are thus being replaced by systems focusing on the results achieved with, in some countries, a range of new organisational forms being established, as for example the agency structures in the U.K., Denmark and Canada. The new flexibilities and results orientation reflect the adoption of some private sector approaches to the management in the public sector. The experience has been that the successful adoption of market-type mechanisms is contingent upon the application of the approaches outlined above.

One area in which market-type mechanisms have been used to improve the allocation of resources is in relation to the goods and services provided by central government for its own departments and agencies. All administrations have a need for certain common support services, for example such things as property (e.g. construction, leasing, maintenance of accommodation) printing and publishing, legal
Overview

and purchasing services, transport, computer services, staff recruitment and training, financial and accounting services. The provision of these services may be organised in different ways -- many have traditionally been provided from within government, either by separate government agencies, often with central financing direct to the agency, or internally within individual ministries, or direct from the market. Often times, such common services have been provided on a centralised monopolistic basis with no cost recovery systems. For example, most governments have had central property management agencies which typically have had funds for rental, maintenance and construction of government offices appropriated directly to them, and often also had a responsibility for regulating the amount and quality of service provided. This paper examines the introduction of at least some elements of market practice into the administrative arrangements governing those "common services" provided within central administrations.

COMMERCIAL APPROACHES TO THE PUBLIC PROVISION OF SERVICES

There are three clearly definable levels of commercialisation which may be required of an agency in relation to the provision of internal-market services:

a) the most basic level is reached when charging, which does not reflect the full economic cost of delivering the service, is introduced; often prevailing accounting systems do not permit a comprehensive cost determination to be introduced; occasionally such limited forms of charging are brought in to acclimatise client departments to the concept of charging. In many countries where "full" cost recovery systems have been in place, these have often not equated to private sector systems because of constraints of central government budgetary and accounting systems which rarely take account of non-cash costs such as depreciation, non-salary costs of labour etc.;

b) when appropriate commercial-style accounting systems, together with a pricing policy reflective of the true economic cost of service delivery, have been put in place, the second stage of commercialisation may be said to have been reached. A decision to operate on a full cost recovery basis usually accompanies this stage of the process. Property Holdings in the U.K. (which holds most of the Government’s large general purpose offices). In many countries, Government printing and computing services in several countries have been established on a cost recovery but monopolistic basis. Nowadays, where practicable, most agencies which reach this stage naturally extend the process of commercialisation to the next stage;

c) advancing to the next stage of commercialisation requires that the agency in question competes, sometimes on fully equal terms, with other rival
suppliers whether in the public or private sectors. This demand side freedom is mirrored by greater supply side freedoms -- control over resources required to produce the service, set against performance targets to be achieved. Internal market service providers in Australia, Denmark and the U.K. tend to operate along these lines. Once this level of commercialisation has been reached, Governments may consider the following questions:

i) whether the agencies involved should compete for private sector business -- there have been some, limited, instances of this -- e.g. the U.K. Civil Service College and a minor element of the services produced by the Australian Department of Administrative Services; or

ii) more radically, whether they wish to preserve such agencies within the public sector or to privatise them fully, thereby making their very survival fully dependent on their market performance. The experience to date has been that Governments, generally, do not wish to take this final step.

The questions which arise are what have been the achievements of these internal markets, how have they been introduced and managed, and what future do they lead to.

SOME RESULTS

Evaluation of internal marketing systems of service is difficult because of data problems inherent in most public sector accounting systems, and because in some countries the changes are too recent. In many instances, it is necessary to rely on somewhat impressionistic qualitative assessments. In the U.K. reports to date from the establishment of markets within departments for basic support services (typing, reproduction, translation and so on) are of a marked increase in quality of services and economies of provision. In Denmark, it is considered by some that the establishment of the Property Agency as a State company in 1990 had been effected without sufficient time being given to plan and carry out all the changes required. In addition, the necessity to make some staff redundant has given rise to negative feelings in certain areas of the Agency. However, the Agency has achieved its required financial results in a competitive environment.

The Australian Department of Administrative Services which provides a large range of services to other government departments (printing, property, transport etc.) commissioned a reconstructed “financial history” of its businesses on a consistent basis covering the last 4 years. While the reconstruction involved some assumptions, it indicated;
Overview

-- an imputed financial operating loss of $120 million on turnover of $1.2 billion was reduced to near break-even over the period;

-- a reduction in staffing levels of some 34%, with further reductions planned;

-- increased real revenue per employee at a weighted annual average of around 5% p.a. (against an estimate for the Public Service as a whole of 3% p.a.).

However, most of the businesses have yet to earn a satisfactory rate of return on funds employed, although on the basis of the latest available information, no budgetary appropriations have been required to subsidise operations.

What cannot be demonstrated conclusively is whether a regime of tight budgetary control, strict enforcement of management targets and associated performance measures would have achieved the same result. However it is clear from country reports that no country is considering stepping back from the changes made to date.

IMPLEMENTATION

There is a range of modifications to traditional forms of management and control which can be introduced to bring about a more commercial approach to service provision; these are outlined briefly below.

Budgetary and accounting systems

On the demand side, it seems critical to the effectiveness of these systems that managers in ministries have the power and responsibility to make decisions on the services they consume. Flexibility can extend from quantity and cost of services to the quality and source. For this power and responsibility to be exercised properly there must be appropriate incentives within the overall budgetary and management system. Many countries, for example Ireland, the U.K. and Denmark, have established over the last decade simplified appropriations for administrative expenses, with central control from the Finance Ministry being limited to the overall amount of expenditure. Under such a system, a manager who can save money on, say, printing, could spend it on office furniture. Other flexibilities, for example the power to carry over expenditure between years and to retain some part of the proceeds of asset sales, can also be an encouragement to manage inputs more carefully.

On the supply side a range of arrangements are possible. Some involve the establishment of net budgeting systems, under which receipts from the sale of services are offset against expenditures, and the appropriation is either zero or a net
amount only. Under this type of arrangement, the manager of a service has an incentive to contain costs and to regularly review charges and seek to increase revenues. Some performance measurement is facilitated in that expenditure will be matched against revenue derived, and relative increases in efficiency can be determined. In the U.K. for example, some executive agencies, known as Trading Funds, have been established; these are outside of the framework of voted finance. Her Majesty’s Stationery Office, which provides printing and publishing services to departments is organised on this basis. In Denmark, National Procurement (the facilitating agency for government supply contracts) is scheduled to become privatised (with the Government as sole shareholder) over the next few years, while parts of the Palaces and Properties Agency in Denmark are to become a limited liability company.

Many countries, e.g. the U.K. are in the process of replacing the prevailing cash accounting procedures with more commercially oriented accrual accounting.

The difficulty for the Budget Office becomes one of gaining an accurate forecast of likely revenues so as to determine a realistic net appropriation, as there is a clear incentive for the supply agency to be conservative in its revenue forecasts. It is also important to ensure that monopoly power is not abused. Of course, progress towards full cost recovery as well as the presence of competition from outside suppliers will lessen the need for budget office intervention of this type.

More radical change can involve the establishment of revolving funds. These give a supply organisation freedom from the annuality of the normal budget process by providing a continuing authority for payments to be made in the performance or production of certain specific goods and services and for the crediting of revenue against the expenditures. The ability to create reserves and borrow gives more flexibility to cope with fluctuations in demand for services and more scope for capital planning than the normal budget process. Revolving funds typically operate where full cost recovery is sought and on a near full commercial accounting basis. This establishes the discipline of proper accounting for such things as depreciation rather than the notional adjustments to direct budgetary costs which have been used in the internal costing systems of some countries. A critical question is whether the size of the operation is sufficient to warrant the creation of separate authority and the accounting structures which accompany it.

The relationship between a body operating on a revolving fund basis and the Budget Office then becomes more results oriented. The focus of external scrutiny is on bottom line performance and discussions with the Budget Office will be on such things as return on capital, establishment of debt/equity structures, capital injections, and operating subsidies if required.

The budgetary system can also be used to supplement the revenue obtained from the provision of a good or service when public interest is deemed to require it, as, for example, to retain capacity in a testing organisation which charges for its
services, or to pay for the maintenance of historic buildings occupied by departments. This system allows the cost of the community interest to be identified separately from the normal commercial operations of the service provider. This is common practice in countries such as France and Canada where public enterprises such as railways are given specific appropriations for the discharge of community obligations.

**Charging Systems**

Critical decisions in this area appear to have been, firstly, whether to charge full economic costs (i.e. all direct cash costs as well as non-cash items such as employer pension costs, depreciation and interest on capital, insurance etc.). Practically any charging regime can be expected to have an impact on the level of demand so long as there is some incentive for the consumer to examine critically the level of his requirement for the service. Opening the service to competition from outside suppliers places an additional incentive on the internal supplier to restrain costs: it also requires that the charging system of the internal supplier be comparable with that of the private sector to ensure fairness.

In Australia, where most of the common services provided to government departments were placed in a single Department of Administrative Services in 1987, the charging system has evolved as other departments have been freed from the obligation to use the various separate businesses (removals and freight, printing and publishing, property services etc.). With the delivery open to competition a more commercial approach to pricing was developed, based on market rates and allowing business to be bid for at a loss (so as to gain access), or at a significant profit (where the market will bear it). Commercially-based financial performance targets based on balance sheet performance and profitability have been set. The medium term performance target is for each business to cover all it’s costs as they accrue and generate a rate of return on funds employed at least equal to the government’s long term bond rate, taking into account relevant industry characteristics and the impact of general economic conditions. These target rates are adjusted to the circumstances of the individual businesses as part of the annual business cycle. The only costs not recovered at this stage are indirect taxes, although the businesses generally price so as to recover the equivalent of these taxes when competing for non-government work, and are aiming to be able to recover these costs in respect of all work undertaken if a review of this issue due in 1993 requires it.

Other countries have to date required only that charges represent full costs. This is the practice in the U.K. for example, under the Government’s Fees and Charges guide. Such charges will include non-cash costs such as insurance, superannuation costs (where not already charged), and depreciation and interest on capital.
Managerial Freedoms

On the demand side, the effect of charging for services which transfers the funding from the supply agency to users of the services offers users greater freedom at least over the quantity of the service they choose to have, and the expenditure on that service. Freedom to choose suppliers has been extended in a number of countries, greatly expanding choice over quality and cost. In Denmark and the U.K. services for which charges are made are usually also opened to competition. In Australia some 50% of the services provided by the Department of Administrative Services are in direct competition with the private sector, a figure which will rise to 85% by 1993. In Ireland minor maintenance of state buildings is open to full competition. In Finland the State Computer Centre, which operated on a full cost recovery basis, had its monopoly ended in 1989 and was established as an off-budget enterprise in competition with the private sector. The same transition was made with respect to printing services in Finland, although a monopoly remains with respect to certain Parliamentary and Cabinet publications. Both the U.K. and Australian printing offices have similar monopolies over Parliamentary printing.

These developments have compelled managers in "customer" departments to assume greater personal responsibility. In this sense the changes have gone hand-in-hand with new systems of strategic planning, performance measurement, accountable management and merit pay which have been introduced into the central administrations of many Member countries.

On the supply side, managers have been given freedom over staff numbers, and there are moves to devolve pay and grading systems to the executive agencies in the U.K., for example. This is the case with Her Majesty’s Stationery office. Managers in supply agencies have freedom to determine the resource mix to be employed in the delivery of their service, for example whether to use in-house or contract resources to meet demands for their services from other departments. Those operating on the revolving fund basis described above also have greater flexibility than provided for in the normal budgetary process in expenditure planning. There are constraints as well as freedoms on the managers of supply agencies. These often relate to pay and conditions of service, including tenure and pension requirements, freedom of information and high standards of public accountability. It has been pointed out by Australia that the high standards of public accountability may also represent an advantage in servicing clients.

A more critical question for governments is whether to allow newly commercialised supply agencies the freedom to compete against the private sector for non-government work. In Australia, the Department of Administrative Services is allowed to compete for work subject to certain limitations, and at present derives some 5% of its revenue from non-government customers. They are actively seeking to foster the growth of such revenue through strategic alliances and joint ventures with private sector parties. Such practices will always attract close scrutiny from
Overview

private sector competitors and parliaments, and raise large issues about the role of
the public sector. In the case of the U.K. a restrictive policy on the question of
allowing Government agencies to compete for non-Governmental business has been
adopted. Generally, surplus capacity may be sold to the private sector provided that
services are charged for on the basis of the full economic cost so that there is fair
competition with the private sector.

Managing the change

The techniques involved in inducing public sector providers to behave like
competitive firms has involved a number of challenges.

The introduction of new accounting methods involves new or upgraded
technology, substantial retraining of accounts staff, training of managers in the use
of commercial-style management information, the acquisition of more general
commercial skills (marketing and sales, customer services and so on). Establishment
of agreed asset valuations and appropriate debt/equity ratios can present a significant
challenge, particularly if many assets have not previously been accounted for.

Management of people issues have been important. Extensive information
exchange, and often lively debate with the unions has been a major factor in
restructuring. Some governments have instituted redundancy programmes to ease
the staff reductions required.

Critical to successful implementation is the behaviour on the demand side.
It is reported that customers have not always been sensible about exercising their
new found freedoms, switching sources of supply rapidly, and causing difficulty for a
supplying organisation which cannot easily run down resources at short notice. The
need for stability between customers and suppliers, whether within the public sector
or not, has led to the establishment of long-term arrangements. The use of service
level agreements is being encouraged.

Governments have also had to take action to prevent Ministries from using
the new freedoms to establish in-house sources of supply for services previously
obtained outside. This has been done by requiring that Ministries establish the full
cost of providing services internally before the decision is made to produce in-house
rather than purchase from the market.

The implementation of the internal market arrangements has been
characterised by a large degree of pragmatism. Australia reports that the process of
untangling departments from the requirement to use the common service supplier has
been adjusted as circumstances of the individual businesses dictate and their
business charters have been modified -- some by an acceleration of the process of
commercialisation, some stepping back. In the U.K., where the Department of
Transport and Industry introduced charging for a range of internal services -- typing, translation, accounts services and so on, the department has recognised that it would need to adopt a flexible approach to cover any shortfall in payments in the first years of the schemes operation.

OTHER ISSUES

The application of internal market systems in many countries gives rise to a number of general questions concerning the future direction of such policies. These questions, together with a tentative response to the issues raised are set out hereunder:

-- Is it always appropriate, and cost effective, to modify well established central purchasing arrangements so that individual departments and agencies may assume more responsibility in purchasing matters?

Traditional arrangements often promote economies of scale in purchasing which cannot be matched by individual departments and agencies. In addition, central agencies have many years of experience in the procurement function. These factors must not be down-played.

On the other hand, the delegation of purchasing responsibility to line departments encourages a more cost-conscious approach towards both the acquisition and utilisation of resources. In the longer run, it is to be expected that this enhanced local management responsibility, especially when it form part of an overall package of measures -- target setting, performance measurement, strategic planning etc. -- will more than outweigh the benefits to be derived from the traditional purchasing arrangements.

-- Do they provide a complement to, or at least a partial replacement for, the range of more traditional performance measures which many governments have introduced into their management systems? Is it necessary to retain centrally imposed, or even centrally agreed, performance targets relating to service quality issues where a government organisation is operating in a competitive environment?

Internal markets generally allow more tangible performance measurements than are possible in many other areas of the public sector. Increasingly, as internal market agencies compete on equal terms with the private sector, market forces will tend to ensure service quality. However, the
Overview

market will not necessarily always deliver such critical requirements as reliability of provision and continuity of service;

-- How suited can any government organisation be in the long run to dealing with business cycles and the impact this can have on a competitive business.

For so long as internal market agencies continue to supply the public sector, business cycles should not be a dominant factor.

-- If, as seems to be the case, the efficiency gains arise from the exposure of services to competition from the private market, why should government agencies remain in the business of providing these services at all? Should the institution of internal markets be viewed as a necessary or desirable intermediate step in the passage to full contracting out or privatisation?

On the evidence to date, most governments view the introduction of MTMs as means whereby greater value-for-money may be introduced into certain governmental services, rather than as an intermediate step towards privatisation. However, in the light of the rapid rate of change both structural and attitudinal which has affected the public sector in most countries over recent years, it would be unwise to make any long-term predictions about the future status of agencies which are currently providing internal market services.

-- Is it necessary to establish specific organisational/operational structures to optimise the benefits of the kind of commercial approach described?

In general, it could not be said that, even within individual countries, single "ideal" organisational models have always emerged. As a general observation, however, agencies providing internal-market services are increasingly being removed from the relatively tightly controlled framework of central government departments/ministries and are being established.

-- What are the implications of E.C. directives regarding public contracts for agencies providing market-type mechanisms?

The implications have not been fully teased out, but these directives will undoubtedly act as a spur towards placing state agencies on a more equal footing with private sector companies.

-- To what extent does the public sector climate impose constraints on agencies providing market type services?
For so long as agencies are in receipt of public funding or remain accountable to Government Ministers, there will inevitably be certain constraints on their commercial activities. For example, they will often be required to demonstrate absolute equity and transparency in the allocation of contracts, their accounts may be subject to scrutiny by parliament or parliamentary committee or they may be subject to unscheduled shifts in policy following upon change of government. To circumvent these difficulties, the tendency generally is remove agencies providing commercial-type services from the constraints of such accountability and influence while leaving them within the ambit of the public sector.
AUSTRALIA

by

John Mellors

(Completed in April 1992)
1. **OVERVIEW**

Since the mid 1980s the Australian Government has pursued a general policy of introducing commercial principles to the management of common services used by its departments and agencies. This policy of "commercialisation" has been characterised by a pragmatic application of techniques such as fees for services based on full costs, commercial accounting systems including balance sheet and profit/loss performance evaluation, and the opening of markets for common services to private sector competition. The great majority of common services subject to this policy approach are provided by the Department of Administrative Services (DAS). This paper summarises the current status (as of June 1992) of the commercialisation process at the Australian federal level for services of interest to the Public Management Service (PUMA). The process is a continuing one and, where possible, future trends or plans are indicated.

The following table summarises characteristics of businesses within DAS. Other DAS common services and common services provided by agencies other than DAS (including self-servicing) are dealt with later.
### DAS BUSINESSES PROVIDING SERVICES IDENTIFIED BY PUMA

<table>
<thead>
<tr>
<th>BUSINESS</th>
<th>SERVICES</th>
<th>MARKET CONDITIONS FOR CLIENT AGENCIES</th>
<th>FUNDING</th>
<th>STAFFING as at FEB 1992</th>
<th>GROSS SALES 90-91 ($Am)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australian Property Group</td>
<td>Accommodation and real estate services</td>
<td>Freedom of supplier except for leases in the Federal Capital</td>
<td>Fully self-funding through trust account</td>
<td>555</td>
<td>52</td>
</tr>
<tr>
<td>Assets Services</td>
<td>Property repairs &amp; maintenance</td>
<td>Partially free now. To be entirely free from July 1993.</td>
<td>Fully self-funding through trust account</td>
<td>3,624</td>
<td>430</td>
</tr>
<tr>
<td>Project Services</td>
<td>Construction management &amp; related consultancies</td>
<td>Freedom of supplier</td>
<td>Fully self-funding through trust account</td>
<td>1,295</td>
<td>148</td>
</tr>
<tr>
<td>Interiors</td>
<td>Fitout design and management</td>
<td>Freedom of Supplier</td>
<td>Fully self-funding through trust account</td>
<td>92</td>
<td>(not in operation 1990/91 previously part of Project Services)</td>
</tr>
<tr>
<td>Australian Government Publishing Service</td>
<td>Publishing &amp; Printing</td>
<td>Tied for jobs over $20,000. To be free from July 1993, except for Parliamentary printing &amp; all publishing</td>
<td>Trust account funded with community service obligations supplemented</td>
<td>879</td>
<td>98</td>
</tr>
<tr>
<td>Fleet</td>
<td>Self-drive vehicle hire</td>
<td>Tied. To be free from July 1993.</td>
<td>Fully self-funding through trust account</td>
<td>366</td>
<td>107</td>
</tr>
<tr>
<td>Comcar</td>
<td>Chauffeur-driven vehicle hire</td>
<td>Free except for entitlees (eg MPs, judges)</td>
<td>Fully self-funding through trust account</td>
<td>517</td>
<td>36</td>
</tr>
<tr>
<td>Removals</td>
<td>Removals brokerage</td>
<td>Free</td>
<td>Fully self-funding through trust account</td>
<td>17</td>
<td>104</td>
</tr>
<tr>
<td>Distribution</td>
<td>Local, interstate and international freight</td>
<td>Free</td>
<td>Fully self-funding through trust account</td>
<td>522</td>
<td>44</td>
</tr>
<tr>
<td>Purchasing Services (including IT procurement)</td>
<td>Procurement contracting &amp; advice; Sale of surplus goods</td>
<td>Sales: free General &amp; IT purchasing free Common Use Contracts: tied</td>
<td>Currently partially on trust account, but to revert to budget funding from July 1 1992 with recovery of cash costs</td>
<td>165</td>
<td>19</td>
</tr>
<tr>
<td>Systems &amp; Tech Services</td>
<td>Bureau and other computing services</td>
<td>Free</td>
<td>Currently budget funded with some sales netted from appropriations</td>
<td>158</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Other DAS businesses which provide services to federal agencies and other clients include:

- Australian Protective Service (Facilities guarding)
Australian Government Analytical Laboratories (Testing and analytical services)

Australian Archives (Records management)

Overseas Property Group (Property management for the government’s overseas estate)

Ionospheric Prediction Service (Prediction of solar-terrestrial changes and communications advice)

Australian Survey & Land Information Group (Mapping and surveying)

Australian Valuation Office (Real and other property valuations)

Australian Estate Management (Management of the domestic owned estate)

Procurement Policy (Policy analysis and advice on government purchasing)

Overall, some 82 per cent of DAS’s current staffing of 12,250 persons are employed in businesses structured as self-funding trust account operations reliant on revenue from clients to meet their costs.

Legal advice to federal agencies is generally provided by the Attorney-General’s Department which is also undergoing a commercialisation process (of a more limited nature than DAS). Other support services such as financial and accounting services, personnel administration and a wide range of IT services are generally provided ‘in house’ by individual agencies as budget-funded operations. The payment of public service salaries is managed on a service-wide basis by the Department of Finance.

Data on total expenditure on, and staffing of, the provision of common services across all federal agencies are not readily available. The budgetary and management reforms of the 1980s, including amalgamation of running cost provisions and the devolution of decision-making on expenditure and sources of supply for common services mean that no central agency now maintains a data base of this kind. For the few services where DAS remains the sole supplier to budget-funded agencies pending ‘untying’ in 1993 (e.g. self-drive cars supplied by Fleet), the total turnover of the service represents a high proportion of total expenditure on that service by federal agencies. In the case of Fleet, only the Department of Defence and off-budget statutory authorities are free to use other self-drive services at this stage. For most other services, where federal agencies are partially or totally untied (e.g. Australian Property Group), the DAS service provider’s income is no indicator of total expenditure on the service because it represents an unknown proportion of
the total work being carried out either by agencies themselves or by the private sector on their behalf.

DAS is in the process of developing a market database to monitor broad estimates of its share of the total federal market, but this information is not sufficiently comprehensive for present purposes. As a broad indicator of relative magnitudes only, the running costs of all federal budget-funded agencies in 1991-92 will amount to some $9.7 billion (including salaries and administrative expenses but excluding rents), representing some 9 per cent of federal budget outlays. The 1991-92 Budget provided for capital works for these agencies of some $1.1 billion. Payments by budget-funded and other clients to DAS for its commercial services in 1991-92 are estimated to be some $1.1 billion (excluding payments for on-passing to property owners and capital works contractors). Estimated cash transactions of DAS’s Business Services Trust Account for the current financial year are shown in the following table.

### BUSINESS SERVICES TRUST ACCOUNT
BUDGETED CASH RECEIPTS AND PAYMENTS
1991-92

<table>
<thead>
<tr>
<th>Receipts</th>
<th>Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>($million)</td>
<td>($million)</td>
</tr>
<tr>
<td>Payments from clients</td>
<td>1120</td>
</tr>
<tr>
<td>Payments from Government:</td>
<td></td>
</tr>
<tr>
<td>. for redundancy costs</td>
<td>25</td>
</tr>
<tr>
<td>. for community obligations</td>
<td>36</td>
</tr>
<tr>
<td>. capital injection</td>
<td>10</td>
</tr>
<tr>
<td>. interest on cash balances</td>
<td>13</td>
</tr>
<tr>
<td>Sale of assets</td>
<td>84</td>
</tr>
<tr>
<td>Total receipts</td>
<td>1288</td>
</tr>
<tr>
<td>Reduction in cash balances</td>
<td>6</td>
</tr>
<tr>
<td><strong>1294</strong></td>
<td><strong>1294</strong></td>
</tr>
</tbody>
</table>

2. DESCRIPTION OF COMMERCIALISATION

The Federal Government has implemented significant reforms of its budgeting, resource allocation and financial management systems and procedures in recent years. Under the general umbrella of the Financial Management Improvement Program (FMIP), departmental managers have been given substantially increased scope to take decisions on the allocation of administrative and program funds within 'bottom line' budgetary limits. Across the Federal Public Service, user pays systems are now the norm for many internally provided services and a purchasing reform process has been implemented. Purchasing reform has focused on maximising value for money, taking into account the entire procurement process rather than excessive emphasis on price and procedural detail. Full cost accounting has, to varying degrees, been an important tool in many of these developments.

These reforms have been carried furthest with respect to services supplied by DAS, with devolution of funding to client agencies, the untying of agencies from use of DAS services and the restructuring of DAS services into self-funding commercial operations. In earlier years funding for the great majority of common services was appropriated to DAS centrally, which acted as both service provider for all agencies and as regulator of these services on behalf of government. Now individual agencies control the funds for these services and they are increasingly free to purchase them from alternatives to DAS.

DAS was created in July 1987 from parts of seven previous portfolios with the express intention of placing within the one department almost all common service providers, allowing a case-by-case review of each enterprise to evaluate whether the government wished it to continue as a service supplier and, if so, under what market conditions. The new Department’s mandate was to set in train "a fundamental reappraisal of the provision of common services to government agencies". By early 1988 the Federal Government had endorsed a set of 23 Principles (see Attachment A) setting a general policy framework for common services against which each business was to be evaluated. Over the following two years almost all of DAS’ operational divisions were evaluated and submissions made to Government on the timing and nature of the changes each should undergo. At Attachment B are summaries of the general characteristics of each business’ initial charter. For the most part the timing, extent and characteristics of commercialisation reflected in each of these charters has been maintained, although certain details have been adjusted as the process has been evaluated at various phases. Over the period 1988-91 the greater part of DAS’s service operations were converted from budget-funded divisions to self-funding businesses operating through trust accounts for the receipt of fee income and payment of full costs. Concurrently, DAS’s earlier responsibilities for regulation of service provision were largely devolved to individual agencies. At Attachment C is a brief chronology of the main decisions and organisational changes pertaining to DAS since 1987.
As part of the commercialisation process major changes have been made within DAS to accounting methodologies, management systems, charging regimes and performance evaluation and reporting. Key systems improvements are summarised below.

**Charging Systems** -- Since the commencement of the commercialisation process, there has been a significant shift in emphasis in the charging regimes employed by DAS businesses. Initially, the objective was generally to recover full costs for each service with both direct and indirect costs being included in calculations for all charges. As the process of opening delivery to competition has progressed, a more commercial approach to pricing has of necessity been taken and DAS’ businesses now charge on the basis of market rates subject to ‘bottom line’ profit targets. In this way services can be priced on genuinely commercial grounds, assessing the likely risks and benefits of any given job being taken on at a loss (perhaps as a means of gaining access to future business opportunities) or at a significant profit (in circumstances where alternative sources of supply are similarly expensive or where the particular service is only peripheral to the core business of the enterprise).

A concomitant of the more commercial approach to pricing has been the development of commercially-based financial performance targets based on balance sheet performance and profitability. A benchmark target for medium-term commercial performance within DAS has been set by DAS management. This is for each business to cover all its costs as they accrue (with one exception noted below) and generate a rate of return on funds employed at least equal to the government’s long term bond rate, taking into account relevant industry characteristics and the impact of general economic conditions. Costs now brought to account include staff superannuation, rents on all accommodation, insurance premiums, interest payments and depreciation. This target rate of return is adjusted to the circumstances of the individual businesses as part of the annual business planning cycle.

The one exception to recovery of full costs at this stage concerns indirect taxes. The Government has determined that DAS should not be required to pay indirect taxes (eg payroll tax) at this stage in recognition of its position as a department of state, which carries with it responsibilities and cost overheads not borne by private sector competitors. In broad terms the exemption from indirect taxes is equivalent to around 5% of DAS’s operating costs, partially offsetting the Department’s non-commercial statutory and regulatory costs. The issue of indirect tax liabilities is expected to be reconsidered in 1993. In the meantime the businesses generally price so as to recover the equivalent of indirect taxes when competing for non-Government work (see below) and are aiming to be in a position to meet this possible liability in respect of all operations if it materialises.

**Budgetary and Accounting Systems** -- All of the DAS commercial operations now operate through a single trust account whereby income from sales
must be generated to cover all costs. Accounting is on an accrual basis with reporting and monitoring being carried out through balance sheets and profit and loss statements in accordance with Australian accounting standards and the requirements of the Minister for Finance for financial statements of the Federal government’s commercial undertakings. As noted below, the introduction of commercial accounting systems including full accounting for assets employed has represented a major challenge. Some quasi-commercial activities which are either insufficiently developed to be commercially viable, or need to be significantly budget-funded for policy reasons, are funded through a net appropriation system where cash receipts partially offset expenditures. DAS’s information technology services, for example, are funded by net appropriations.

Under these arrangements, planning and control of DAS’ finances have largely become a matter for internal management. External scrutiny (i.e. by the Department of Finance and Parliament) has become more results oriented, with attention directed at “bottom line” performance and service quality and quantity issues. Negotiations with the Department of Finance are now confined largely to key structural issues (e.g. the establishment of debt/equity structures of the businesses) and the annual estimates of financial transactions with the Consolidated Revenue Fund. Nevertheless, DAS remains subject to all of the usual external obligations pertaining to a department of state (e.g. comprehensive annual reporting, scrutiny of annual estimates by Parliamentary committees).

While no operating subsidies have been provided from the Budget since 1990-91 some of DAS’s commercial businesses continue to receive payments from the Budget for Community Service Obligations (CSOs). Total CSO payments for all businesses in 1991-92 are some $36 million, around 3 per cent of expected DAS trust account revenue this year. CSO funding represents a significant proportion of the total revenue of the Australian Survey and Land Information Group (to support Australia’s national mapping program) and the Australian Government Analytical Laboratories (to maintain a reserve testing capacity for food imports/exports). Five other DAS businesses receive lesser amounts of funding as payments by the government for the servicing of community obligations.

Two major issues facing DAS and the government with the establishment of trust account operations were the setting of agreed asset valuations for the businesses and appropriate debt/equity ratios. The former issue presented problems in determining values for assets which had not previously been accounted for. The debt/equity issue gave rise to a lengthy negotiation process with the Department of Finance, eventually resolved by a compromise under which 50/50 debt/equity ratios were adopted for all businesses. The debt component of the net funds employed by each business bears interest payable to Consolidated Revenue at the long-term bond rate. The equity component may attract a dividend, as determined by the Ministers for Administrative Service and Finance, having regard to trading results and other factors.
Managerial Freedoms & Constraints (Demand Side) -- As indicated, DAS’s commercialisation has greatly extended the options open to federal agencies in respect of sources, cost, quality and quantity of service, consistent with the broader FMIP reforms of the 1980s.

The transfer of funding for common services from DAS to client agencies has given agencies the power and responsibility to make resource allocation decisions which were previously dictated by central priorities. These funds are now allocated to agencies under three broad appropriations, namely Property Operating Expenses, Capital Works and Running Costs, and consideration is currently being given to introducing further flexibility by amalgamating appropriations for property operating expenses and other running costs.

In many instances departmental managers have also been given the freedom to choose suppliers other than DAS, which is now in direct competition with the private sector for around 50 per cent of its present revenue. With the changes decided upon by Government in March 1991, this figure will rise to at least 85 per cent by 1993.

Complementing this extension of competitive supply arrangements has been the purchasing reform process, under which agencies are now able to make purchasing decisions on value for money grounds. In the Information Technology area, for example, agencies are no longer required to use DAS’ services in procuring IT solutions.

Where departments decide to provide common services from within their own resources (i.e. rather than procuring them from either the private sector or DAS), then such decisions have to be justified on the basis of their full cost to the Commonwealth (see the relevant Finance Regulation at Attachment D).

Managerial Freedoms & Constraints (Supply Side) -- As DAS remains a department of state, it is subject to all legislation and regulations applying to the Federal Public Service as a whole (eg pay and conditions of employment, including tenure and superannuation entitlements, external scrutiny and accountability, freedom of information). This imposes certain cost penalties in the provision of services which are not borne by DAS’s private sector competitors although it is arguable that some ‘constraints’, for example high standards of public accountability, may also represent a marketing advantage in servicing public sector clients.

Within the general parameters applicable to all departments, however, the Government has determined a number of specific “freedoms” uniquely tailored to DAS’s situation as a department of state with commercial performance objectives, including:
the ability of DAS businesses to bid for non-Commonwealth work (within
guidelines laid down by the Minister for Administrative Services);

central monitoring but no central control of the staffing profile for senior
executive positions in DAS’s self-funding businesses;

resource management flexibilities inherent in the operation of DAS’s trust
account (e.g. greater flexibility in expenditure planning than normally
provided by the budget cycle); and

budget supplementation for redundancy programs in recognition of the
transitional costs of commercialisation (since July 1987 around 1 900 staff
have received voluntary redundancy packages, with a further three year
program agreed by the Government in March 1991).

More generally, and less formally, the adoption of clear commercial objectives
has created an environment within the federal administration in which central
oversight focuses increasingly on bottom line outcomes rather than on input control.
As regards oversight by the federal Parliament, DAS is now an entity combining
characteristics of traditional Budget-funded departments of state and off-Budget
government business enterprises. This has led to some debate regarding the form of
Parliamentary oversight most appropriate to DAS’s structure and operations.

Management of the Transition -- The implementation of the Government’s
commercialisation strategy has been characterised by a pragmatic, case-by-case
approach whereby the Principles at Attachment A were used to assess businesses.
There was no blanket determination to cast all the services in the same mould. The
result has been a series of carefully drafted individual business charters which tailored
the extent, nature and timing of the commercialisation process to the circumstances
of each case. Over time, too, the Government has been prepared to accelerate or
slow down the reforms as each case was presented to it. In the case of Purchasing
Services, for example, the business is likely to step back from full commercialisation
because of mounting evidence that a fully commercial approach (perhaps putting the
interests of the business ahead of those of the Government at large on occasion) is
inappropriate for this function. Fleet on the other hand is to be fully untied in 1993
when untying was not part of that business’ original framework. In the early years of
the process the Government continued to provide significant budgetary operating
subsidies to support the transition process but these have now been phased out
(cross-subsidisation still occurs within the single trust account, in a readily identifiable
manner).

One of the most difficult and important changes DAS has undergone in the
last five years has been the introduction of accrual accounting for businesses which
were previously operated under the standard cash accounting system traditionally
used in the public sector. This change has proceeded in parallel with, rather than in

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advance of, the introduction of fees for service and has entailed a substantial amount of 'learning by doing'. The introduction of accrual accounting systems has involved information technology upgrades and/or replacements; extensive retraining for accounts staff; overcoming knowledge deficits through recruitment in a very competitive labour market; and training managers in the appropriate use of commercial financial data. The management and control of invoicing and debtors proved one of the more difficult adjustments, complicated by the fact that debts due to DAS by other federal departments of state are not legally enforceable (because the federal government forms a single entity for legal purposes). Although DAS is still not in a fully satisfactory position with regard to the consistency and reliability of its management information, major advances have been made, with sales, costs, debtors and creditors now routinely monitored each month.

The acquisition of more general commercial skills (e.g. marketing and sales, customer service, etc.) has also been a major focus of DAS’s implementation efforts. While public servants generally have experience of cost management and control, the generation of sales revenue through sales and marketing strategies is generally unfamiliar. The development of skills in this area has been a high priority.

Traditional public service organisation structures within DAS have also been found wanting as vehicles for achieving a more customer oriented and commercial enterprise. As a result DAS is evolving its structures so as to maximise customer access to DAS services. The Department’s management structures, for example, incorporate a series of business-specific boards plus a departmental board, with customers, unions and private sector commercial skills represented. These boards advise senior managers on commercial strategies and directions.

Management of people issues (e.g. training, communications, consultation) have been central to DAS’ progress to date. Extensive consultation with staff and their representatives has enabled commercialisation to be implemented, including the voluntary redundancy programs mentioned above, without a major industrial dispute. Open information exchange and (at times) lively debate with the union movement has been a critical success factor in the restructuring of DAS. Representatives of the twenty-nine unions with membership in DAS have been closely involved in the reforms through the DAS National Consultative Council and its sub-committees. Given the need for further redundancies and continued restructuring of work practices DAS faces the challenge of maintaining its co-operative working relationship with its unions over the next 2-3 years. The likely introduction of a form of ‘enterprise bargaining’ within the Australian Public Service in the near future is seen by DAS and its unions as a major opportunity to maintain the momentum of productivity improvement.

One area in which management of the transition might have benefited from closer examination concerns the creation or expansion of in-house support service by individual agencies as an alternative to external provision by DAS or the private
sector. While no overall assessment is available it is clear that in some cases, untying of agencies from use of DAS services has encouraged the establishment of in-house services elsewhere. It is unclear whether, if costed on a basis comparable to that now applicable to DAS, such actions would represent a cost effective use of resources. The recent introduction of a Finance Regulation requiring full costing of self-servicing arrangements (see Attachment D) partially addresses the issue. However, the cash accounting systems traditionally employed in the public sector discriminate against procurement of goods and services from external sources at full cost when "below the line" costs of in-house resources are not properly accounted for. This has the potential to disadvantage both DAS and its private sector competitors.

A further lesson of the transition has been the importance of addressing issues of ethics and accountability. The introduction of commercial disciplines and 'bottom line' performance criteria give rise to sensitive accountability issues. These include tensions in setting priorities, conflicts between the requirements for public disclosure and the protection of commercially sensitive information, and an initial tendency amongst staff to assume that the commercialisation process provides a licence to pursue (typically misinformed concepts of) 'private sector management practices'.

It has been necessary in DAS to emphasise, through the dissemination of corporate codes of conduct and other means, that the commercialisation process does not in any way dilute the high ethical standards expected of DAS staff as public servants. Indeed the maintenance of a reputation for probity, fair-dealing and avoidance of conflicts of interest is seen as a marketing strength. Nor does commercialisation lessen the accountability of DAS staff to the Minister, a fact which some tend to lose sight of on occasion.

DAS has found no obvious precedents to guide it as it seeks to combine the traditional accountabilities of a department of state with its commercial objectives and performance criteria, which can give different answers on occasion in day-to-day decision making. It is seeking to clarify the roles of the Minister and departmental managers through a framework drawing on accountability structures applicable to federal government business enterprises but tailored to DAS's status as a department. In seeking to combine these diverse accountabilities successfully as a department of state DAS is probably unique in Australian public administration.

3. EVALUATION

There are four main perspectives from which to evaluate the commercialisation of common services within the federal administration:

- DAS’s own productivity and profitability;
- the management of the commercialisation process;
. federal expenditures as a whole and the extent to which federal agencies now obtain greater value for money in purchasing support services;

. the extent to which customers within the federal sector (including the Government itself) are more or less satisfied with the level and quality of services they now receive.

The following points address these perspectives in turn. The four perspectives are, in fact, inextricably linked and each only provides a part of the total picture.

Productivity Improvements within DAS -- Because of the many changes in funding and accounting arrangements affecting DAS since 1987 data on productivity trends cannot be derived readily from published sources. In 1991 the Department commissioned financial consultants to reconstruct a 'financial history' of DAS on a consistent measurement basis for the period 1987-88 to 1990-91 inclusive. This work is only now nearing completion and has entailed many assumptions in relation to, for example, interest on capital and depreciation rates. As shown in the graphs at Attachment E, their draft report indicates that:

. an imputed financial operating loss in 1987-88 of some $120 million on turnover of $1.2 billion (1990-91 prices) was reduced to near financial break even in 1990-91;

. average staffing levels for the commercial businesses within DAS have fallen from an annual average of nearly 14,000 in 1987 to 11,400 in 1990-91 and 9,900 as at February 1992 (as indicated above, further reductions are planned);

. within the commercial businesses, real revenue per employee has grown since 1987-88 at a weighted average of around 5% p.a. (average annual labour productivity growth across the Australian Public Service over a similar period has been tentatively estimated by the Department of Finance to have been 3% p.a.).

In 1991-92, for the first time, DAS received no operating subsidies from the federal Budget. However, while substantial progress has been made in eliminating the large underlying operating losses incurred by DAS businesses in earlier years, earnings have fallen short of business plans for 1991-92 to date and most of the businesses have yet to achieve a satisfactory rate of return on funds employed. This will not prove easy in the intensely competitive conditions currently prevailing in DAS's key markets such as the construction and related industries, where cash flow needs rather than accounting profits currently dominate private sector pricing practice.
Managing the Process -- Although management of the commercialisation process is an issue of means, not ends, it merits evaluation in its own right. In DAS’s case the approach has been to focus on achieving performance improvement through commercial approaches without becoming sidetracked by the issue of ownership of resources or lengthy debate over the rationale for public sector involvement.

The scope of the changes necessary to fully implement a commercial approach to the provision of common services was probably underestimated at the outset. Traditional public service approaches to business planning, organisation structure, accountability, performance evaluation, resource management, industrial relations, devolution of decision making and customer relations have in varying degrees been found wanting in a commercial environment. DAS’s lack of a legal identity distinct from the federal administration at large poses difficulties on occasion. Above all, the scale of the task involved in changing staff attitudes from a preoccupation with existing services and procedures to a focus upon servicing client needs was, with hindsight, underestimated. While substantial investment has been made in staff training and awareness, this is now being further upgraded in the areas of client service, marketing and financial skills in particular.

Overall, however, while details of the commercialisation process might in retrospect have been better anticipated, management of the process as a whole is generally considered a success. Substantial efficiencies and economies have been achieved within DAS in parallel with the phased untying of agencies from mandatory use of DAS services. Within the framework of the objectives and constraints set by government for the process none of its basic features would, with hindsight, have been managed differently.

Federal Expenditure and Value for Money -- As indicated earlier, the impact of commercialisation of common services on federal expenditures in aggregate cannot be quantified. With limited exceptions, no additional ‘efficiency dividend’ was sought from federal agencies as they were untied from DAS in anticipation of savings they would make through commercialisation. The aggregate running cost provisions for federal agencies have continued to incorporate a standard annual 1.25% efficiency dividend set without reference to commercialisation as such. Thus rather than generate specific, identifiable savings to the federal budget (other than those arising in DAS itself), the commercialisation process has helped federal agencies meet their overall efficiency dividend requirement and released budgetary resources within agencies for higher priority needs. Insofar as the matter can be judged, there has been no reduction in the value for money derived from the provision of common services to federal agencies.

Customer Satisfaction -- To some extent the commercialisation process has raised the expectations of customer agencies. With the devolution of funding to clients, DAS’s service costs and quality come under far closer scrutiny by customers. As a result, the early years of commercialisation saw significant levels of
dissatisfaction among the Department’s customers. This was characterised by impatience on the part of some customers for a faster untying timetable.

More recently, DAS’s market intelligence and evaluation of customer satisfaction, while still developing, has improved in sophistication and comprehension. This reveals a wide range of expectations and perceptions among clients, depending on regional, agency and business characteristics. Nevertheless, DAS’s research indicates that the Department is perceived by customers as having the following characteristics:

- a strong, unique and possibly sustainable advantage as a department of state, whereby DAS has a better chance of understanding the customer’s needs than a less informed private sector competitor;
- not always strong on value for money or “track record” (DAS’s prior history as a regulatory agency is a burden under commercialisation) but, in comparison to its competitors, more compatible with the people, culture and systems of federal agencies;
- lacking skills and experience in marketing when compared to competitors (especially in face-to-face situations).

It will be noted that the research focuses on DAS’s performance relative to its competitors, not its own past performance, since only the former is relevant to DAS’s future in a competitive market place. Anecdotally, however, customers have generally praised DAS’s efforts to transform its services and acknowledge improvements in service quality achieved over the past five years.

4. FURTHER DEVELOPMENTS

As DAS moves closer to achieving commercial levels of performance in an untied market environment, a number of issues are coming into sharper focus. These include:

- recent trading results and forecasts for businesses suggesting a need in some cases for further restructuring of operations and upgrading of commercial skills to enhance prospects for long term viability;
- perceptions in some quarters of potential conflicts between DAS’s residual policy advising activities on behalf of the Federal Government at large and its services to individual customers;
as noted previously, moves by some agencies to establish in-house services, for example in relation to property management, as an alternative to using either DAS or the private sector;

- questions regarding the extent to which DAS businesses should seek to off-set loss of market share in its ‘traditional’ market (federal agencies) by increasing sales in non-federal markets, including the private sector.

As regards competition for non-government business, DAS is permitted by Government decision to compete for this work subject to guidelines approved by the Minister for Administrative Services. In general terms, limitations imposed by the Federal Constitution act to restrict services to non-federal government customers to those which are ‘incidental’ to the services provided to the federal public sector. At present, some 5% of DAS’s commercial revenue derives from non-government customers. However, DAS businesses are actively seeking to foster growth of such revenue by way of strategic alliances and joint ventures with private sector parties. Services to non-government customers tend to attract close scrutiny from private sector competitors and Parliamentarians.

Future directions for DAS’s commercial operations are currently under review. This will seek to further clarify the Government’s expectations of performance in relation to DAS’s commercial services having regard to progress to date and issues of the above kind. While the federal Opposition parties have announced a policy of further contracting-out and partial privatisation in relation to the common services supplied by DAS, no fundamental change is anticipated in the present government’s policy approach.
ATTACHMENT A

Principles for the operation of services to Government agencies

Principles applicable to all DAS services

PRINCIPLE 1

Efficiency and effectiveness in the achievement of government objectives, assessed against the full range of economic and social objectives to be achieved, is the ultimate test against which arrangements for the provision of services should be judged.

PRINCIPLE 2

Options and arrangements for the provision of services should be assessed on a case-by-case basis and be the subject of full consultation with client agencies and relevant implementation. Principles for services should provide a framework for the conduct of such case-by-case assessments rather than seek to specify uniform delivery arrangements for all services.

PRINCIPLE 3

Any changes to future service arrangements should be implemented over an appropriate period in order that service providers and client departments may be afforded an adequate adjustment period, and that government may have the opportunity for review in the light of experience.

PRINCIPLE 4

Devolution to individual departments of management responsibilities for the supply of services, whether by way of managing in-house supply or contracting supply from the private sector, should satisfy the test that service supply by individual departments is more cost-effective than supply by a central service agency from the perspective of the Commonwealth at large (as distinct from the perspective of individual departments).

PRINCIPLE 5

Each service unit should be managed in accordance with a written management "charger" endorsed by the responsible Minister and/or Cabinet as appropriate.
PRINCIPLE 6

Each unit supplying a service should provide the responsible Minister with a corporate plan covering periods of three to five years ahead for consideration and approval.

PRINCIPLE 7

If Government decides that policy objectives of functions extending beyond the supply of a basic service to clients are to be pursued, these should be identified explicitly in the management charter and corporate plans for the service in question and be taken into account in assessing the service agency’s performance.

PRINCIPLE 8

All service agencies should be in a position to inform Government of the costs of the services they provide, including costs which they do not fund directly under current arrangements (e.g. superannuation, rent). Program departments managing and/or providing their own services as significant undertakings in their own right should be in a position to report their costs in similar detail.

Principles relevant to those DAS services for which Government decides it is appropriate to charge

PRINCIPLE 9

Services which do not contain any significant "public interest" component should be charged for unless it can be demonstrated that the costs of implementing and operating charging systems exceed the potential efficiency gains.

PRINCIPLE 10

Where in accordance with Principle 9 the majority of a service agency’s services are properly chargeable, its financial objective should, in general, be to at least recover its costs from revenues after allowance for the financial effects of meeting any "public interest" obligations forming part of the management charter for the service(s) in question.

PRINCIPLE 11

The introduction of charges should normally be accompanied by devolution of responsibility to program departments for bidding for associated funding. However, requirement for policy advice to Ministers regarding the expenditure and other implications of the resulting bids of individual departments for such funding.
PRINCIPLE 12

Where charges are made for services, client departments should normally receive and control the appropriations available to acquire the services. However, if charges are introduced for a service subject to a tied client arrangement, case-by-case consideration should be given to the desirability of the supplying agency having control over the funds (through appropriation or sub-warrant control arrangements).

PRINCIPLE 13

Introduction of charges for a given service with devolution of associated funding to departments should be accompanied by supplementation of clients’ budgets, the level to be decided on a case-by-case basis.

Principles relevant to those DAS services which Government decides should operate on a quasi-commercial basis

PRINCIPLE 14

Where the Government considers it appropriate to commercialise a service the relevant service agency should normally be structured with a distinct identity with a departmental framework.

PRINCIPLE 15

Insofar as program departments re permitted to contract services from the private sector in accordance with Principle 4, they should be required to seek price quotations for the required service from existing Commonwealth agencies.

PRINCIPLE 16

The cost-effectiveness of service management or provision by individual program agencies should be subject to external scrutiny no less rigorous than that applied to service provision by central service agencies.

PRINCIPLE 17

Subject to achievement of their overall financial targets and consistent with commercial practice, service agencies should retain full management discretion in relation to the structure and level of charges for their individual services to individual clients. Where service agencies retain a degree of "monopoly power" in relation to a given service, disputes regarding the level or structure of charges for that service should be referred to the responsible Ministers if not resolved between the service provider and its clients.
PRINCIPLE 18

Where a service agency is expected to operate as a quasi-commercial undertaking with charges for its services predominantly set on a cost-recovery or commercial basis, the agency’s finances should normally be conducted through Group 2 Trust Account arrangements.

PRINCIPLE 19

The disposition of the net surplus (if any) of the service agency after payment of all costs, should be considered annually against the general principle that surpluses will often need to be retained by the agency to finance future requirements of the agency.

PRINCIPLE 20

Where service agencies are established as quasi-commercial undertakings and operate through Group 2 Trust Accounts, their annual financial reports should be prepared in general accord with the Minister for Finance’s “Guidelines for the Form and Standard of Financial Statements for Commonwealth Undertakings”.

PRINCIPLE 21

Service agencies operating in competition with the private sector should not be subjected to audit or disclosure requirements entailing disclosure of information of potential benefit to competitors.

PRINCIPLE 22

As a first step in establishing any quasi-commercial services agencies, and subject to agreement regarding their "bottom line" financial targets, they should be free to exercise a high degree of management discretion and flexibility by removal of controls in respect of:

- ASL and staffing profiles;
- the resourcing mix to be adopted in service delivery (directions regarding the mix of in-house and contract resources);
- the use of fee receipts in meeting operating and capital expenses;
- the structure and level of fees for services to individual clients; and
- reporting requirements other than those applicable to government business enterprises and to meet the reporting requirements of the Parliament.
PRINCIPLE 23

Service agencies operating on a full cost-recovery basis in competition with the private sector for Commonwealth business should be free, subject to the agreement of the responsible Minister (if not already current practice), to compete for non-Commonwealth business.
### SUMMARIES OF BUSINESS CHARTERS FOR DAS BUSINESSES OPERATING IN THOSE AREAS IDENTIFIED BY PUMA  (ATTACHMENT B)

<table>
<thead>
<tr>
<th>BUSINESS</th>
<th>DATE OF GOVERNMENT DECISION</th>
<th>KEY POINTS</th>
<th>TIMING OF COMMERCIALISATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transport &amp; Storage (now Fleet, Comcar, Removals &amp; distribution)</td>
<td>1 September 1987</td>
<td>Self funding on a full cost basis.</td>
<td>Financial and administrative arrangements effective from 1 October 1987.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Full cost charge rates (now commercial rates)</td>
<td>Small, progressively reducing subsidy to assist with Comcar competition with Taxis. Now phased out.</td>
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<td></td>
<td></td>
<td>Full supplementation of departments and budget-funded agencies.</td>
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<tr>
<td></td>
<td></td>
<td>Private sector competition on most business (exceptions were: Comcar, with MPs and office holders tied; Fleet [now to be untied in July 1993])</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Prohibition on self-servicing by agencies.</td>
<td></td>
</tr>
<tr>
<td>Australian Construction Services [now Assets Services, Project Services and Interiors]</td>
<td>7 July 1988</td>
<td>Customer agencies to remain tied until 1 July 1991 for design and construction requirements. Tying to be retained for all asset management work (now to be untied from July 1993).</td>
<td>Civil staff housing responsibility delegated to departments and agencies from 1 July 1988.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Public interest work to be budget funded.</td>
<td>Commercial rates for asset services to be charged for off-budget clients from 1 July 1988 and on-budget clients from 1 July 1989.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Review possible further delegation of authority to clients.</td>
<td>Full cost recovery for design and construction work to be achieved over three years from 1 July 1988.</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>Trust account established from 1 July 1989.</td>
</tr>
<tr>
<td>BUSINESS</td>
<td>DATE OF GOVERNMENT DECISION</td>
<td>TIMING OF COMMERCIALISATION</td>
<td>KEY POINTS</td>
</tr>
<tr>
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</tr>
<tr>
<td>Australian Property Group (now Australian Estate Manager and Australian Property Group)</td>
<td>26 July 1988</td>
<td>Controls on resources lifted for property services from 1 July 1988 in those areas for which fees were already charged and from 1 July 1989 for all other services.</td>
<td>Property Management: Retain overall estate management responsibility; Government business enterprises (GBEs) free to manage own estates; to continue budget funding; revenue from sale of excess property to continue to be paid into consolidated revenue.</td>
</tr>
<tr>
<td>Australian Government Publishing Service</td>
<td>31 October 1988</td>
<td>Chargeable services to be self-funded from 1990.</td>
<td>Sole Supplier status to be retained for all Parliamentary and “core” printing.</td>
</tr>
<tr>
<td>Purchasing &amp; Sales Group (now Purchasing Services and IT Contracts &amp; Standards)</td>
<td>6 December 1988</td>
<td>Commercially based fees to be charged for all services except those performed in the public interest.</td>
<td>To develop, in consultation with unions, removal of constraints (e.g., staff ceilings and salary limits).</td>
</tr>
</tbody>
</table>
## ATTACHMENT C

**CHRONOLOGY OF MAJOR DECISIONS AND EVENTS IN COMMERCIALISATION OF DAS’S SERVICES**

<table>
<thead>
<tr>
<th>YEAR</th>
<th>DATE</th>
<th>EVENT</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>1987</td>
<td>14 July</td>
<td>Administrative Arrangements Orders</td>
<td></td>
</tr>
<tr>
<td></td>
<td>24 July</td>
<td>DAS formally established</td>
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<tr>
<td></td>
<td>1 Sept.</td>
<td>Transport &amp; Storage Group decision</td>
<td></td>
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<tr>
<td>1988</td>
<td>23 March</td>
<td>Cabinet agreement to 23 Principles for Common Services and direction that 13 businesses be reviewed by Cabinet</td>
<td>from July: New arrangements approved for various businesses</td>
</tr>
<tr>
<td>1989</td>
<td>1 March</td>
<td>Cabinet called for a joint DAS/Finance memorandum reviewing the common service reform process</td>
<td></td>
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<tr>
<td></td>
<td>16 March</td>
<td>Joint memorandum presented</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1 May</td>
<td>Government decision to carry out complete review of commercialisation progress, examining scope for additional reforms.</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>February</td>
<td>17 Businesses reorganised into 3 major programs (Property Services, Sales &amp; Supply and Government Services)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>November</td>
<td>Revised government Information Technology purchasing arrangements (untying DAS services in IT contracting)</td>
<td></td>
</tr>
<tr>
<td>1991</td>
<td>March</td>
<td>Rearrangement of services within programs to better group services for client interface.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>March</td>
<td>Government decision to give DAS a three year target to maximise commercialisation within the department of state context (with further untying to around 85% of work performed by July 1993)</td>
<td></td>
</tr>
<tr>
<td>1992</td>
<td>February</td>
<td>Major reorganisation of DAS into &quot;commercial&quot; and &quot;non-commercial/departmental&quot; streams, removing purchasing functions from trust account and creating a separate purchasing entity within the Department.</td>
<td></td>
</tr>
</tbody>
</table>
ATTACHMENT D

FINANCE DIRECTION CONCERNING SELF-SERVICING
BY BUDGET-FUNDED AGENCIES

DIRECTION
25F - "Where a Commonwealth department or agency that operates on the public account produces or plans to produce goods or services that would otherwise be purchased on a commercial basis from the private sector or another Commonwealth body (e.g. the Department of Administrative Services) such in-house production must be justified having regard to its full cost to the Commonwealth."
SELECTED INDICATORS OF DAS FINANCIAL PERFORMANCE 1987/88 TO 1990/91

Source: Financial History of the Department of Administrative Services, Coopers and Lybrand, February 1992 (Draft)
Australia

NG C.OMMERCIAL BUSINESSES: REAL REVENUE AND OPERATING COSTS (1990/91 PRICES)
ESTIMATED OPERATING PROFITS/LOSSES OF GAS COMMERCIAL BUSINESSES

PROPERTY SERVICES

SUPPLY SERVICES
Real Revenue per Employee: DAS Commercial Businesses

Real Revenue/ASL ($'000)

Revenue expressed in 1990/91 dollars
Employees expressed on annual average Staffing Levels
Average annual growth of real revenue per ASL for commercial businesses (weighted) - 5.0% p.a.
DENMARK
1. **OVERVIEW**

The principal internal market services where market type mechanisms have taken effect are:

a) The Palaces and Properties Agency;
b) National Procurement Denmark; and
c) The Accounting Directorate of the Finance Ministry.

2. **PRESENT POSITION**

2.1 **Palaces and Properties Agency**

Services: The Agency is a State Enterprise since 1990, and its functions include the provision and running of the central administration’s premises, the maintenance and reconstruction of these premises and the security, cleaning, office layout etc. It also has charge of running the royal palaces and gardens.

Market conditions for clients: since the establishment of the Agency, the monopoly of service which formerly existed has been removed, except in relation to security and cleaning of central government offices in the Copenhagen area (for security reasons) and certain refurbishment projects in listed and protected buildings.

Funding: service charges are levied on client institutions which are intended to reflect the market situation for similar offices in private buildings. The Ministry of Finance decides the proportion of the service charges which may be kept by the Agency to cover running costs.

Staffing: 958 covering 5 distinct executive divisions and including staff involved in security, cleaning, provision of furnishings and operation of the telephone system for central administration.

Receipts: DKr 729 million; the net cost is DKr 43.5 million.

2.2 **National Procurement Denmark**

Services: National Procurement was established in 1992 as a State Enterprise; it evolved from the former Directorate of State Purchasing of the Ministry of Finance. The main objective of National Procurement is to ensure that the entire purchasing activities within the government sector -- including the wider public sector -- are carried out in an effective manner. This may be subdivided as follows:
-- preservation of the framework contract strategy. Under this strategy, co-ordinated large scale purchasing is undertaken by groups of larger government institutions, each having their own expertise as regards certain sorts of goods. Framework contracts are normally only considered worth establishing when there is a large number of institutions concerned and when the expected sales amount to approximately DKr 1 million. Framework contracts cover goods and services such as: computers, furniture, office supplies and machines, telephones, vehicles, fuel, food, printing, hotel bookings and travel insurance. The strategy is expected to produce (1) the use of fewer resources on purchasing functions, (2) lower prices, (3) more uniform qualities, (4) better common conditions, and (5) a greater chance of influencing the use of certain sorts of goods (e.g. those which are environmentally friendly);

-- the management of the framework of the strategy -- including, inter alia, the administration of a common system of information to the relevant government institutions about the contents of such contracts and the publication of guidelines relating to specific purchasing issues;

-- provision of consultative help and training to the institutions; and

-- analysis and supervision of the purchasing system.

Market conditions for the clients: the agency does not, itself, provide supplies to client institutions. As already noted, it acts as a facilitator. Clients are free to approach National Procurement for advice, or to seek such assistance elsewhere including in the private sector. Since the mid-1980s, government institutions have been free to choose whether or not to use most of the framework contracts, if they are able to purchase the goods on better terms from another supplier.

Funding: National Procurement is in the process of becoming fully self-supporting: in 1993 it is expected to cover 33% of its costs, in 1994, 60% and by 1995, 100%; these revenues are derived from fees charged by National Procurement. Individual state institutions bear the cost of purchasing the goods and services covered by the framework contracts.

Staffing: 17.

Receipts: in 1993 the projected receipts of National Procurement will be DKr 5 million (ahead of the requirement set for the agency); the total cost of the agency is DKr 9 million.

2.3 The Accounting Directorate (a branch of the Finance Ministry)
Services: The Directorate was made a State Enterprise in 1990. The principal functions of the Directorate are the development, maintenance and operation of the following governmental computer-based financial systems: the Central Accounting System, the Central Salary System, the Salary Information System, the Central Pension System, the Pensionable Age Calculation System and the Central Budget System.

Market conditions for clients: ministries and agencies may develop their own financial management systems provided that satisfactory linkages can be established between the central system and those proposed for local development by the ministries and agencies including ensuring that adequate security exists for the handling of payment orders. Firm guidelines are being put in place for the preparation of the agencies’ own financial management systems which will ensure that a minimum standard for the operation of the internal financial management and accounting systems exists and that the central authorities’ demands for information may be met.

Funding: full user payments for the accounting and payroll systems have been introduced since 1990. However, the Government subsidises a number of the Directorate’s statutory tasks which cannot be run on a commercial basis.

Staffing: 200.

Receipts (1991): DKr 163 million; total expenditure amounted to DKr 198.2 million.

3. DESCRIPTION OF COMMERCIALISATION

A number of major initiatives have occurred in the 1990s, which relate directly to the development of market-type mechanisms for internal markets. These reforms owe their origins to the philosophy which emerged in the 1980s and are the culmination of changes which took place within the institutions in question during that decade. Included among the changes have been:

-- the reformation of the Directorate of State Purchasing as National Procurement Denmark. The agency is expected to operate on fully commercial lines covering all it costs, including salaries, pensions, buildings etc.;

-- the Property Department of the Ministry of Housing along with accompanying institutions and sections of the Building Administration became a state company in January 1990, the company was known as the Palaces and Properties Agency. The Agency is expected to operate on a fully commercial basis. An important element of the new
arrangements has been the decentralisation of responsibility within the Agency -- finance functions were established in all divisions of the Agency;

- the decision to organise the Danish State Accounting Directorate into a Government Public Enterprise as from 1990 (a government public enterprise is mainly controlled on the basis of financial net result targets and is exempted from various budgetary controls) and to include full user payments for the accounting system and the payroll system. Other systems which cannot be operated on a commercial basis are to be subsidised by the Government.

4. EVALUATION

There has been a radical overhaul of Danish central government organisation and accounting practice particularly since the 1980s and this has left its mark on the manner in which central government agencies provide services for other central institutions. Major strides have been taken to remodel these agencies along commercial lines. As is to be expected, such a radical set of reforms has yielded some difficulties along with many favourable results. The position in so far as it affects each of the three agencies concerned shall be summarised hereunder:

**National Procurement**: the agency is in a transitional phase with the objective of becoming a fully, self-financing company by 1995. So far, National Procurement’s story is one of success: it is on course to achieve its desired objective by the target date of 1995. Detailed consideration has been given to the performance of the Agency, including the undertaking of a survey in 1991 to evaluate the efficiency in purchasing at the local level in accordance with the original principles of co-ordinated purchasing through the use of framework contracts. The following issues emerged:

- the institutions generally viewed the services of the Directorate of State Purchasing (as National Procurement was then styled) in a favourable manner, although they had reservations about the administration of the system of information on the contents of the framework contracts;

- the executives in the spending institutions in general showed only sporadic interest in the performance of their purchasing personnel;

- the organisation of purchasing in the institutions differs greatly; to a large extent it was based on pure tradition;

- the widespread decentralisation of the purchasing duties to non-professionals was not followed up by adequate training;
the Directorate found it difficult to get accurate information on the extent to which alternative purchasing of goods has been undertaken which could have been purchased under the framework contracts. They have also experienced problems in eliciting the reasons for alternative purchasing and the profits deriving from such purchasing.

**Palaces and Properties Agency:** the establishment of the new Agency was accompanied by the introduction of a number of critical measures deemed necessary to ensure the success of the new approach. Among the measures were: technological acquisitions, design programming and marketing, formalised employment policy, educational measures, redundancies and employment of new staff. The result of these measures has been that the business has achieved the expected financial results in a competitive situation. The Agency has also achieved many less tangible results: it has become more efficient, more customer conscious, more flexible and management and staff now demonstrate more commitment to the tasks assigned to them.

On the negative side, the Agency considers that it had insufficient time to plan and carry out all the required changes: only nine months were given. Because no resources were earmarked to carry through the reforms, it was necessary to dismiss a number of staff in order to offset the cost of EDP-equipment. This situation gave rise to negative feelings on the part of some employees towards the new company. In addition, some employees of the Agency consider that the change-over occurred too fast. Furthermore, a number of customers have developed their own control systems and administrative units, which seem to duplicate the work of the agency. A lot of resources are expended in registration and invoicing; when EDP systems and routines are fully introduced, the effort will probably be reduced.

There are two major problems still unresolved:

a) Danish public accounts operate with the concept of "expenses", while it is more relevant to focus on costs as seen from a company’s viewpoint. While there is no solution in the offing at present, it is hoped, with the assistance of a private firm of accountants, to get ideas to structure a simple costs account; and

b) when one division of the Agency undertakes a task for another it will naturally be interested in having all expenses covered. It is quite difficult to transfer resources/revenues within the same "juridical" unit.

**Accounting Directorate:** the Directorate has been successful in living within its targets. In 1991, when account is taken of Government subsidies for non-commercial services, the Directorate achieved a surplus of DKr 5.6 million which was transferred into its savings account. It would seem that the effect of the more commercial approach being adopted has been to make the Directorate more efficient.
and effective -- an objective which was achieved following the taking of some tough decisions, including compulsory staff redundancies -- and to encourage ministries and agencies to adopt a more discerning attitude in relation to their use of the services of the Directorate.

5. **FURTHER DEVELOPMENTS**

*National Procurement* is required to become fully self-financing by 1995. Within approximately five years, it is intended that National Procurement will be fully privatised with the Government as the shareholder. The primary source of income will be a percentage charge on the turnover of the framework contracts supplemented with a subscription payment for the services furnished by National Procurement. National Procurement will assume direct responsibility for the establishment of almost all framework contracts instead of using other large government institutions, in order to enhance the quality of the contracts. The marketing of the contracts will be promoted more vigorously and information on their updating will be modernised and simplified. Regional and local institutions will gradually be offered membership of the services from National Procurement in order to expand the turnover and the profits. National Procurement will consider how best to reach executives of the various institutions with relevant guidance concerning the profitable organisation of local purchasing functions. Furthermore, more adequate statistical information on the use of framework contracts and on alternative tendering will be established.

There will be problems associated with any attempt to tighten the joint purchasing system. A return to compulsory contracts would run counter to the concept of the decentralisation of decision making which is such an integral component of the Danish reforms. The adoption of an educational approach towards increasing the use of the system is, therefore, more likely to be adopted -- within the limits imposed by the resources available to National Procurement.

There are no plans for National Procurement to compete for private sector business. The concern would be that the demands of business survival might jeopardise the provision of the services to the public sector.

*The Palaces and Property Agency*: at present the Agency, in conjunction with the Ministry for Finance, is involved in formulating proposals on the scope for converting certain component parts of the Agency into a limited liability company. This scrutiny poses a dilemma which may not lend itself to an entirely satisfactory resolution: since the existing remit of the Agency means that it is not possible to transform the entire institution into a limited liability company and since the divisions and products of the Agency are very integrated, management are faced with the possible outcome whereby a division could emerge between, on the one hand a fully commercial company and, on the other, a more traditional state institution.
It is not intended that the Agency will become involved in the provision of services to the private sector.

*The Accounting Directorate:* the Directorate has begun to offer consultancy services to ministries and agencies on a fully commercial basis, providing expert advice on the development of their own internal financial management functions. This type of work is seen as offering increasing opportunities for the Directorate in the years ahead. In 1992 some DKr 0.5 million was taken in revenues from such consultancy work while it is expected that some DKr 1 million will be realised in 1993.

There are no plans for the Accounting Directorate to compete for the provision of accounting services to the private sector.
IRELAND
1. **OVERVIEW**

The systems through which central government provides goods and services for government departments, offices and agencies have been evolving over the past decade. The principles underlying these changes have been the perceived needs to:

a) confer more autonomy on user departments, offices and agencies in such matters as choice of supplier and cost control;

b) introduce a more commercial approach towards the provision and use of such services;

c) introduce greater accountability on the parts of both the suppliers and users of these services; and

d) improve the quality of service for users.

The vast majority of these services are now provided, or facilitated, by the Office of Public Works (OPW). Previously, all such services were provided directly and funded without recoupment by the OPW. Internal market mechanisms have been introduced in regard to three functions of the OPW:

a) the Government Supplies Agency;

b) maintenance of state buildings; and

c) provision of furnishings and fittings for state buildings.

The other major service provided by the OPW is the provision of accommodation and arrangement of building projects. There are moves towards charging for the provision of this service (although this issue is being examined) -- all relevant costs are borne on the OPW budget and there are no recoupment mechanisms. OPW also arrange contracts for the supply of fuels and departments order their supplies directly from contractors.

In addition, there are many other services provided centrally to departments, offices and agencies (in a few of these cases some charges are levied): Civil Service Training Centre, Management Services and Operation Research Units of the Department of Finance, Central Information Technology Services of the Department of Finance, Attorney General’s Office, Chief State Solicitor’s Office, Valuation and Ordnance Survey, Land Registry and Registry of Deeds, Central Statistics Office and the Meteorological Service.
2. PRESENT POSITION

The detailed ‘internal market’ type services which are currently provided are summarised below:

2.1 Government Supplies Agency (a branch of OPW)

Services: stationery, clothing and materials, printing and binding, sale of publications (through Government Publications Sales Office), all non-military transport and fuel.

Market conditions for clients: users are obliged to use the services of the GSA.

Funding: all users have specific provision in their budgets. The direct cost of items purchased (i.e. exclusive of staffing, handling, storage etc. costs, which are borne by the GSA itself) is charged to the user. In addition, an agency fee (which does not cover all costs) is charged to customers. The shortfall is met by budget funding direct to the GSA. In the case of Government publications, the GSA carries out all marketing and distribution functions and returns receipts from sales to the appropriate government organisations, less an agency fee.

Staffing: 130.

Receipts: £1,643,000 (1992) in respect of agency fees only; a figure for the total running costs of the GSA is not readily available.

2.2 Maintenance (part of Property Branch of OPW)

Services: upkeep and repair of state buildings. This is discharged through (a) the Central Building Maintenance Workshops (CBMW) in Dublin which carries out maintenance works directly (there are also small workshops in Cork and Limerick). They tend to concentrate on minor or emergency maintenance works, although, occasionally, they also undertake minor new works when staffing resources allow; and (b) the contracts section which arranges with private contractors for the undertaking of such works -- this latter service is organised on a regional basis through architects and clerks of works employed by the OPW, who supervise such "contracted out" projects.

Market conditions for clients: users are free to use the services provided by the OPW as described below or within certain limits relating to cost and requirements for professional expertise, to approach private contractors directly, without first approaching OPW. In practice, users very often seek a quote from the CBMW as well as from private sector contractors, before awarding a contract.
Funding: all users have specific allocation for maintenance in their own budgets. Minor works which are undertaken by the CBMW are charged on the basis of a flat fee whereas, in the case of larger projects, an agency fee is charged. OPW also carry out certain minor maintenance work (e.g. drains clearance, roof repairs etc.) for all government offices on a regular, rota basis; no charge is levied for this work. Certain "prestige" buildings (e.g. President’s residence, Prime Minister’s Office, Parliament Buildings) are exempted from any charge. Maintenance projects which are placed with a contractor through the OPW’s contracts section are charged to Departments on the basis of the contractor’s charge plus 3% to cover travelling and subsistence costs incurred by the architects and clerks of works involved in the projects.

Staffing: 380 (67 architects and clerks of works, 290 industrial staff and 23 administrative/clerical staff)

Receipts: £2,000,000 received from users for services provided by the CBMW. The total running costs of the Maintenance area are not readily available.

2.3 Furnishings (provided by the Furniture Branch, OPW)

Services: provision of furnishings and fittings for state buildings; renovation of certain types of furniture.

Market conditions for clients: users are required to purchase certain standard items of furniture from suppliers nominated by the OPW and with whom OPW have arranged supply contracts. They are also required to avail of the services of the OPW Furniture Workshops, where appropriate, and pay for such services. Users must arrange for sale of surplus furniture by the OPW, the receipts from such sales are credited to the budget of the user concerned. OPW must be engaged to supervise the fitting out of premises where they have not already been engaged to carry out the work on an agency basis.

Funding: users have specific provisions in their own budgets which covers the full cost of purchasing items of furnishing. Supplier invoices are paid by OPW who, in turn, charge the users. The OPW charge an agency fee of 5% in return for advice given to users on arrangement of supply contracts, inspection of furnishings, advice on furniture lay out etc.

Staffing: 40 (4 administrative/clerical, 6 technical and 30 industrial staff).

Receipts: £100,000 from agency fees; details on the total cost of providing this service are not readily available.
3. DESCRIPTION OF COMMERCIALISATION

There have been several policy decisions taken at Government which have introduced the elements of commercialisation outlined above. While some have been of a general nature, others have been specifically targeted at the agencies which provide services to central government.

All Departments and Offices must appoint Supplies and Accommodations Officers who are responsible for the control of all maintenance and supplies orders and the purchasing of fuel for their organisations. All invoices must be channelled through the Supplies and Accommodation Officers.

**Budgetary system:** the most recent significant change impacting on the commercialisation process has been the introduction in 1990 of delegated administrative budgets for all Government departments and offices. Among the items for which this delegated authority is conferred on departments are the three areas described at 2 above. Under these arrangements, departments and offices are allocated a three-year operating budget to cover the cost of administrative management. A key element of this system is that organisations may, of their own volition, transfer funds within certain limits from any expenditure subhead within the administrative budget to any other. It is no longer necessary for departments and offices to seek prior approval from the Department of Finance for items of expenditure within the administrative budget area except from certain major IT contracts.

In 1987, the Government took a number of decisions which would require departments and offices to pay for certain services which had hitherto been free of charge. The new charging systems were to apply to, inter alia, energy costs (fuel, light etc.). Under the new arrangements, the OPW would continue to place contracts for supply of fuels and departments and offices would order their supplies direct from contractors. The contractor would invoice the ordering department/office. In the case of electricity and town gas, users would also be responsible for settling their own accounts. They also decided that departments and offices would be individually responsible for the purchase and supply of their own office furniture, including the furnishing and fitting out of rented premises. Under the detailed application of this decision, nine specified functions were to remain with the OPW, while departments and offices were assigned eight distinct duties and responsibilities. With effect from 1989 onwards, it would be a matter for departments and offices to make their own calculations of the amounts which would be required in their budgets for items of furnishing. Another initiative was taken in 1988 when detailed instructions were issued in relation to the maintenance of government offices. Under these regulations, departments have some responsibility for their own maintenance works since January 1989.

In the area of departmental publications, printing costs are paid for by sponsoring department, while distribution etc. costs are borne by the GSA; in such
cases, 60% of the revenue from the publication returns to the sponsoring department or office, while 40% is retained by the GSA. Since 1992, the Government Supplies Agency has been active in the commercial marketing of its activities and has begun to compete directly with the private sector for the printing and publishing of government booklets. In such cases, the entire proceeds from the publication accrue to the GSA itself.

4. EVALUATION

The changes outlined are best considered separately from the perspective of the supply side and the demand side.

Supply side: the changes outlined represent only a partial movement towards the development of market type mechanisms for the provision of services for central government. In the first instance, the changes only affected a limited range of such services. In the second, while the decisions in those areas which were earmarked for change have been largely implemented, they fall short of a fully market-oriented approach.

The initiatives taken since 1987 have had significant organisational implications for the OPW. The element of competition introduced has tended to focus attention on work practices -- mainly among industrial staff -- and staffing levels which are not in keeping with a market-led ethos. Measures have been taken to remedy some of these deficiencies: some changes have been effected in work practices and reductions in staffing levels have been achieved. In the furnishings area, for example, the number of industrial staff has been reduced from 90 in 1987 to a current level of 30; these staff reductions have been achieved through a combination of redundancy and non-replacement of staff retiring. Similarly the GSA numbers have fallen from 190 in 1988 to the current level of 130. The element of competition has also contributed to a heightened awareness of the need to increase the output of the staff who are still engaged on such work.

While much work remains to be done in the areas of accountable management and the development of commercial accounting principles and practices, it is evident that even within the prevailing management and financial system, the reforms have given rise to a significantly greater awareness on the part of management and staff within the OPW of the relationship between input costs and output receipts and its commercial significance. In both the GSA and the CBMW new accounting systems are being installed which would allow for more accurate and comprehensive costings of services. Existing accounting systems within the remainder of OPW do not allow for a thorough-going measurement of commercial performance in so far as they do not permit a factoring in of total input costs. In this climate, it is not possible for market forces to operate effectively.
The services outlined are not, of course, being provided in an entirely free market situation. Managers in the OPW, as in other areas of the civil service, must acknowledge realities which are not part and parcel of the operating climate in the private sector. A different form of accountability accompanies the decision-making process in the civil service than is the case in the private sector. Any expenditure on internal market services, regardless of whether it is borne on the budget of the supplier or the end user, must be met from public funds. As such, Parliament, through the Public Accounts Committee, is entitled, and indeed obliged, to scrutinise on behalf of the citizen the manner in which all such monies are spent, both in relation to propriety and efficiency. To take but one example, within the civil service context, necessarily elaborate tendering procedures must be observed in order to ensure that no preference is shown in the awarding of contracts; the private sector is not bound by the same restrictions. Changes which might be deemed acceptable or desirable in the private sector may, in the civil service context, assume a somewhat different significance.

A number of factors support the continuance of a central purchasing function such as is provided by OPW. By their nature these factors militate against the development of a more competitive approach to the provision of services:

a) often it is possible for OPW to achieve purchasing economies because they purchase in greater bulk than would any single department or office;

b) in comparison with user departments and offices, the relevant services in OPW have amassed years of experience in such matters as price negotiation, the drawing up of contracts and quality evaluation; and

c) OPW has considerable professional and technical expertise readily available.

There have been some problems of interpretation in relation to the detailed application of the various reforming directives as well as, occasionally, a less than completely satisfactory communication of these directives to the relevant officials in user departments and offices. This has resulted, on occasion, in some users assuming responsibilities which, in so far as the OPW are concerned at any rate, were not conferred by the appropriate directives.

Demand side: the assignment of individual allocations to departments and offices for such items of expenditure as furnishings, general office supplies and office maintenance has contributed significantly to a growing awareness within these organisations of the real costs of such services and of the necessity to display prudence and a due sense of economy in relation to the placing of orders and the selection of suppliers (where this is an issue). This more commercial outlook has been greatly reinforced by the introduction of the delegated administrative budget system already mentioned. Of course, as users of the services in question,
departments and offices will never face precisely the same types of commercial considerations which confront private sector organisations in the same situation. As in the case of the OPW as supplier, the purchasing department or office must primarily concern itself with accounting propriety and the public service environment in which they operate. The private sector business, on the other hand, concerns itself to a large extent with purely commercial considerations when it decides to purchase the services in question.

Under the administrative budget arrangements, departments and offices are free to increase their level of expenditure, within certain limits, under any of the constituent categories, provided that they do not exceed the aggregate total for the administrative budget as a whole. While this flexibility is an important element of these arrangements, it can give rise to certain problems insofar as the services covered by this study are concerned. For example, there have been cases where two civil service departments or offices shared the one building and where the managements concerned have set differing expenditure priorities within their budgets, resulting in significant contrasts in the standards of furnishings and maintenance being adopted. Cases such as this, obviously give rise to adverse staff reactions. Examples of what may appear to be unnecessarily lavish office maintenance or furnishings, obviously give rise to questions being raised from the expenditure control point of view as well.

Difficulties with regard to the interpretation and communication of the reforming directives have already been touched on as a supply side difficulty; these difficulties also arise on the demand side. For example, while most departments and offices place their orders for new furnishings with suppliers recommended by the OPW and through the agency of the OPW - which seems to be the intention of the relevant directive -- others do not. This divergence in approach may also stem from a view held by some users that it would be faster and more efficient to deal directly with the private sector suppliers than to involve the OPW. There have also been some problems with regard to the definition of what constitutes maintenance work -- and projects have been undertaken under the delegated sanction arrangements which seem to have been more extensive in scope than the original directive would permit.

5. FURTHER DEVELOPMENTS

The existing financial accounting systems in the OPW are designed to meet the requirements of accountability already mentioned -- and this they do most successfully. However, they are not intended to meet the needs of an increasingly market-oriented service. For instance, it is not possible to abstract easily the total cost of running the various market-type services operated by the OPW. Consideration is being given at present to the possibility of introducing a new accounts system which would make it possible to identify the real commercial cost of the various operations. Such systems are currently being installed in the GSA and the CBMW.
The GSA has already made strides towards a more market-driven approach with a greater emphasis on marketing through mail shots etc. and direct competition with the private sector. The results of these initiatives to date have been encouraging. It is expected that such initiatives will be maintained and, indeed, become more commonplace in the immediate future.

The broader changes occurring across the civil service, such as the comprehensive introduction of administrative budgets and the initiatives which are being taken to introduce meaningful strategic and corporate planning in departments together with systems of accountable management, target setting and merit pay for senior management will increasingly combine together to create a more business-oriented ethos in the civil service as a whole. This shift in outlook and attitudes, which has already begun, is working its way through into a greater awareness, both within user departments and offices and within the various centralised providers of services, of the need for:

- greater competitiveness on the part of the OPW in relation to the services which it provides itself;
- more cost consciousness within user departments and offices in so far as the services for which they are required to pay are concerned;
- the more widespread adoption of charging systems in respect of other services provided to other areas of the civil service.

A working group is now examining government accounting procedures with a view to securing greater accountability and transparency in the use of resources in all areas of the Civil Service.

At present, the application of the OPW directives is being reviewed within the Department of Finance. While it is not possible to say at this stage what changes will emerge from this review, all sides would agree, however, that there is a need for greater clarity in the interpretation of some elements of the directives. The review is also addressing itself to the problems which arise when departments, while living within their administrative budget, spend what are considered to be excessive amounts on furnishings or maintenance. Regardless of what proposals emerge from the review, it is clear that the approach of charging for services is here to stay.
UNITED KINGDOM
1. **OVERVIEW**

Major changes have taken place in the structures of government departments and in Government accounting practice since the 1980s. A government department providing a service to another department is now, normally, expected to charge for the service; the introduction of charges for services is intended to ensure that resources are allocated efficiently. Increasingly, services are being delivered by executive agencies which have been set up under the *Next Steps* initiative. These agencies charge for their services and produce commercial-style accounts. Some of these agencies are funded through the traditional voted monies approach, while others, which are classified as *Trading Funds* conduct their financial affairs on a more commercial basis.

Charges for goods and services should normally be set to recover the *full* cost of the service within the year. Costs are normally calculated on an accruals basis and include the total cost of all resources used in supplying the service (i.e. the sum of all direct and indirect costs). The U.K. Treasury produced a comprehensive guide in 1992 entitled *The Fees and Charges Guide*. The purpose of this publication was to provide up-to-date guidance, in the light of the major structural and accounting reforms which have taken place in the UK civil service, on the costing and pricing of the goods and services supplied by government departments, agencies, trading funds and certain other public bodies.

A number of governmental organisations operate market type mechanisms in their provision of goods and services for other branches of the central administration. The principal services involved are:

- Government Property Service;
- Government Printing and Publishing Services;
- Transport Services;
- Treasury Solicitor’s Department;
- Recruitment and Assessment Service;
- Civil Service College.

2. **PRESENT POSITION**

The relevant details concerning the ’market-type’ services are summarised below:

2.1 *Government Property Services*

Services: the government’s property estate is divided into two halves:
United Kingdom

a) the "common user estate", which is held centrally by an agency called Property Holdings. This category comprises most of the Government's large, general purpose offices; and

b) the "departmental estate" which is held by individual departments and comprises smaller and more specialised properties.

A Governmental agency called the Property Services Agency (PSA) carries out construction and maintenance work.

Market conditions for clients: departments must pay property repayment system rents (PRS rents), including passing rents, to Property Holdings in relation to their tenancy of both "common user estates" and "departmental estates". Departments are not obliged to use the services provided by PSA; in fact, work on construction and maintenance is generally contracted out.

Funding: both Property Holdings and PSA are vote financed. However, Property Holdings receives PRS rents, while PSA charges for its services.

Staffing: (i) Property Holdings: 680; (ii) PSA: 11,606.

Receipts (1992-93):

a) Property Holdings: PRS rents receivable for the government estate: £865.1 million, club subscriptions in respect of common user estate properties amount to £166.1 million; running costs for Property Holdings amount to £24.4 million;

b) PSA: £521.3 million; running costs in respect of PSA for the same period amount to £522.6 million.

2.2 Government Printing and Publishing Services (Her Majesty's Stationery Office -- HMSO)

Services: provision of printing and publishing services to Government departments.

Market conditions for clients: users are not tied to the HMSO. They may provide these services in-house or contract out.

Funding: HMSO is a Trading Fund and thus operates outside of the vote finance framework. HMSO funding is derived directly from charges levied.

Staffing: 3,284
Receipts: there is no figure available for receipts from other central government bodies. The accounts for 1991 show turnover of £380.6 million; this includes income from parliament, local authorities, nationalised industries and other areas of the public service as well as from central government departments. Data on running costs are not available.

2.3 **Transport Services**

Services: provision of secure transport for ministers and senior officials.

Market conditions for clients: while departments must avail of this service for transportation for ministers and senior officials, they also run their own fleets of cars and other vehicles for other uses.

Funding: this service operates on a repayment basis.

Staffing: 211

Receipts: (1992-93) £8.3 million; running costs (including salaries and all overheads) £6.6 million in same period.

2.4 **Treasury Solicitors Department**

Services: provision of legal services for government departments and other non-departmental public bodies.

Market conditions for clients: larger departments tend to have their own internal legal services while other departments use the services of the Treasury Solicitor.

Funding: funded through the annual voted estimates, but charges users for services.

Staffing: 521.

Receipts: £19.9 million in 1992-3 from both government departments and non-governmental public bodies. The estimated running costs of the Treasury Solicitors Department are £24.3 million in 1992-93.

2.5 **Recruitment and Assessment Service (RAS)**

Services: the RAS is organised as a Next Steps Agency; it provides a full range of professional recruitment and related services for government departments and agencies and the wider public sector.
Market conditions for clients: managers in departments and agencies are now free to choose how to arrange the recruitment of all their own staff -- the only exceptions are the most senior people and "fast-stream" entries.

Funding: funded through annual voted estimates but users are charged for the services provided.

Staffing: 229.

Receipts: £13.8 million in 1992-93; running costs in same year £13 million.

2.6 Civil Service College (CSC)

Services: the Civil Service College is organised as a Next Steps Agency; it is the central training agency for both the civil service and other governmental and private sector clients.

Market conditions for clients: larger departments have their own internal training services; no department is tied to using the CSC.

Funding: the College is funded through voted monies but users are charged for services provided.

Staffing: 235.

Receipts: £13.9 million in 1992-93 (including receipts from non-civil service areas); running costs during the same period £14.4 million.

3. DESCRIPTION OF COMMERCIALISATION

The UK Government has been developing the principles of charging for services for many years. This movement towards commercialisation was given considerable impetus in the 1980 arising from a strong Government commitment to making the public service more commercially based and accountable. During the 1980s a number of radical initiatives were taken which sought to change the orientation of the public service towards the direction desired by Government.

The most significant change in the structure of central government departments has been the establishment of executive agencies. In 1988 the Prime Minister announced that the Government had accepted the main recommendations of the report of the Efficiency Unit entitled "Improving Management in Government: The Next Steps". Insofar as practicable, all executive functions of government, as distinct from the formulation of
policy advice, would be carried out by clearly designated units, which are referred to as Executive Agencies.

The main aim of the Next Steps initiative is to deliver services more efficiently and effectively within available resources, for the benefit of taxpayers, customers and staff. A Next Steps agency may be funded through votes (the more traditional format) or it may be a Trading Fund; in either event, the agency will charge for its goods and services and produce commercial-style accounts. In the case of Trading Funds, all receipts collected are credited to the Fund. A Trading Fund has a minimum financial requirement to break even and may have a further financial objective. Surplus receipts may, inter alia, with Treasury agreement, be put to revenue reserves. Surplus receipts which are unintentional and are put to revenue reserves may be used to mitigate or to eliminate increases in charges which would otherwise be required in the following years. If a Trading Fund is unable to meet its total costs (including debt servicing) in any year the deficit must be met from revenue reserves where these are available or from additional borrowing. Where a Trading Fund delivers an unplanned deficit in any particular year charges for future years must be adjusted to ensure that its financial objectives are met.

Systems of accounts: most Executive Agencies and all Trading Funds are required to produce externally audited accruals-based accounts as soon as possible after the end of their financial year. Not all agencies have reached this stage yet. For any non-agencies in net running cost control, fees should be assessed on a full cost basis and Memorandum Trading Accounts should be maintained; these are operating accounts (which may be supported by a balance sheet) rather than auditable commercial-style accounts showing the outturn of each service. These accounts should be presented on an accruals basis, though the degree of sophistication would be less than that of agency audited accounts. Any agencies which are neither Trading Funds nor on net running cost control are also obliged to produce audited accruals accounts, though not all will have reached this stage.

Charging: the critical development from the perspective of this study has been that a general policy is now in place under which inter-departmental services are expected to be charged for in cash. There are a few inter-departmental services which are supplied without cash-charging (on "allied services" terms). No new inter-departmental service costing £1 million or more per year may now be provided without cash charging unless the Treasury so agrees. Even where a service is provided on allied service terms, the customer department must be informed of the cost of the service provided. The detailed application of these arrangements is set out in the 1992 Fees and Charges Guide which reflects the many fundamental changes which had taken place in the structures of Government, in Government accounting practice and in the attitude of Government towards the public service since the previous edition of the Guide was published in 1983. The basic philosophy informing these guidelines was that payment provides the customer department with a greater incentive to use goods and services efficiently and economically, and results in more accurate presentation of costs which in turn assists managers in the decision making process. It is further considered that payment also encourages supplying
departments to provide goods and services which represent value for money. A key element of the Guidelines is that customer departments should not normally be tied to a supplying department but should be free to purchase services from whatever source can provide the best value for money.

Charges should normally be set at such a level as to recover the full cost of the service being provided within the year in question (subject to a degree of necessary flexibility). Departments have discretion with regard to the means by which they take account of the full cost of providing these services.

Both the Treasury and the customer departments should be consulted at the earliest possible stage when a supplier department is considering introducing cash charging for services. Normally an eighteen month period would elapse between the commencement of consultations and the introduction of charging to ensure adequate time for all necessary consultations on such matters as:

-- precise definitions of the services which will be affected and the individual items for which charges will be levied;

-- contractual responsibilities and conditions, including performance measurements and the method and frequency of charging;

-- agreement on the level of the service presently received and that envisaged for the future; and

-- an estimation of future charges and whether VAT will be payable.

In addition, departments must have sufficient time to ensure that the necessary arrangements including accounting procedures, transfers of public expenditure provisions, estimates cover and invoicing procedures are put in place. With regard to invoicing, there is a need to ensure complementarity between the systems used by both the invoicing department and the department being invoiced.

Departments are also moving towards charging for services provided in-house. This process is underway in relation to the provision of printing and publishing services. While not many of the general administrative services provided internally are being charged for, some initiatives have been taken in this direction, particularly in the case of executive agencies which are often required to pay their parent departments for their usage of common services.

Managerial freedoms: where charging regimes are set up, customers are usually untied. The degree of managerial freedom which is accorded to the supplying agency depends on its status. Executive Agencies are being invited to accept full responsibility for their own pay and grading regimes, whereas entities within core departments generally
have less freedom. Customer departments may be tied to using departmental suppliers where:

- aggregate demand results in an overall benefit even though one or two customers individually may do better by going elsewhere;
- national security considerations pertain;
- there is a need for uniform standards.

The degree of managerial freedom (in financial terms) varies depending on the nature of the agency:

- gross running costs control: restricted to keeping within gross provisions;
- net running costs control: can increase expenditure in year to meet unplanned increases in demand. They must keep within net control total. Supplementary Estimates are needed for extra expenditure and receipts;
- trading funds: can increase expenditure in year to meet unplanned increases in demand. They must meet financial objectives (break even and typically earn specified return of capital). Trading Funds operate outside of the vote finance framework.

Management of the transition: there have been considerable teething troubles and painful lessons have had to be learned. Customers within departments have not always been sensible about exercising their new-found freedoms. It is not easy for a supplying organisation which is part of the civil service to run down its resources at short notice when its customers have switched to alternative sources of supply. The department is therefore liable to incur extra costs when this happens. However, departments are now learning that they need to establish intelligent long-term arrangements which provide reasonable stability between customers and suppliers, whether those suppliers are in the private sector or within the civil service. The use of service level agreements is being encouraged.

Industrial relations have not posed any particular problems. The unions are much more concerned about the market testing and contracting out of services and, by comparison, they look favourably on internal markets. The impact of the development of internal markets for pay determination has been of limited significance up to now. HMSO is the only agency which has its own pay and grading arrangements. They are negotiated laboriously but in the end agreed with the Trades Unions. A number of other agencies began to conduct their own pay negotiations from 1 April 1993, but this development is not specifically related to the emergence of internal markets.
4. EVALUATION

These developments are too recent for it to be possible to quantify the impact. Such reports as are available indicate that the effects of introducing market-type mechanisms have been considerable. The indications are that there have been marked increases in quality of service as well as economies. In one small department operating on repayment, the introduction of internal charging has changed the cash-flow of the organisation from negative to positive.

Problems are being reported too, of difficulty in getting bills paid and of customers taking too short-term a view and causing disruption which can be costly for the department. Important lessons are being learnt about the need to purchase services intelligently and to maintain reasonably stable and predictable relationships through the use of supply and service agreements. In some areas, over elaborate charging arrangements have been introduced, the cost of which has been out of proportion to the benefit of charging: in the Treasury Solicitor’s Department, for example, extraordinarily detailed invoices covering many pages were initially sent out to users. The system has now been rationalised and is working well. In general these can be regarded as teething problems and most managers believe that the development will be beneficial and will justify the costs and disruption involved.

5. FURTHER DEVELOPMENTS

Exploratory work is now being done on the development of accruals accounting systems for departments generally. One of the advantages of such a development would be that it would provide a means of displaying transactions between departments and agencies. The cash based Supply Estimates, which are used to some extent as the basis for accounting for internal charges at present are not well-suited to this purpose.

The UK Government has adopted a restrictive policy on the question of allowing Government agencies to compete for non-government business. There is a presumption against allowing Government agencies to increase their share of the market, but it is recognised that in certain circumstances, and subject to strict conditions about fair pricing, it can be sensible to utilise spare capacity in this way. Some Government departments have shown an interest in selling surplus capacity to other departments. This raises similar issues in principle, since those departments might otherwise have purchased the service from the private sector; but it is not regarded as so sensitive and is in fact encouraged provided that the services are charged on the basis of the full economic cost so that there is fair competition with the private sector.
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