

## USE OF PERFORMANCE CONTRACTING IN NORWAY (\*)

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### EXECUTIVE SUMMARY

The development of performance contracts in the Norwegian government administration has been encouraged by new financial regulations. There are two main contractual arrangements which encapsulate and formalise the ministries' control of executive agencies: Letters of allocation define the resource allocation, performance targets and reporting requirements for the more than 300 subordinate agencies'. The documents are the result and the basis for a management dialogue between the Ministries' and executive agencies about roles and responsibilities. At the individual level, a top management contract scheme was introduced in order to deal with wage competition from the private sector. The scheme embraces both a pay-level and a performance-related element. Even though both types of performance contracts are linked Norway still faces the challenge to co-ordinate these performance management tools.

(\*) Also refer to the synthesis document: [PUMA/PAC(99)2] *Performance Contracting: Lessons from Performance Contracting Case-Studies & A Framework for Public Sector Performance Contracting*, and to the other related case-studies of Australia, Belgium, Canada, Denmark, Finland, France, New Zealand and Spain, all available on the OECD netsite (<http://www.oecd.org/puma/>).

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## TABLE OF CONTENTS

|                                                            |    |
|------------------------------------------------------------|----|
| 1. Introduction                                            | 3  |
| 2. Letters of Allocation                                   | 4  |
| 3. Top Management Contract Scheme                          | 8  |
| 4. The Connection between the Various Management Processes | 11 |

## USE OF PERFORMANCE CONTRACTING IN NORWAY

### 1. Introduction

#### *Norwegian Public Administration*

In Norway, the King personifies the executive power, whereas responsibility effectively rests with his Council (the Council of State) which is comprised of the Prime Minister and 18 other ministers. The Constitution vests the greatest power in the *Storting*, the legislative branch of government, which also has budgetary powers.

In addition to the prime minister's office, central government currently has 16 ministries, each headed by at least one minister. Each ministry is comprised of several departments. The ministries employ a total of about 3 700 civil servants.

Public service delivery, administration, monitoring and research are provided by more than 300 executive agencies at the ministries' disposal. These agencies may be classified in three groups:

- central agencies without regional representations;
- central agencies with regional representations; and
- regional representations directly subordinated to a ministry.

#### *A New Performance Management Orientation*

As with many other countries, Norway's public administration has undergone a period of decentralisation. The background to this lies not only in a steep increase in workload, but also in a clear perception that delegation of responsibility and management makes for improved performance. Consequently, there has been a move away from a management framework focusing on laws, rules and procedures, to one with a stronger focus on performance and control through cash limits and delegation of responsibility. This has resulted in greater freedom for the individual institution, leading in turn to a need to formalise communication between ministries and their subordinate agencies.

The development of performance management in the central government administration culminated on 26 January 1996, when the government by royal decree laid down new regulations for financial management in the government administration. The regulations went into force on 10 January 1997, and ministries and subordinate agencies have until 1 July 1998 to make the necessary adjustments.

The purpose of the regulations is threefold: to improve control of the use made of central government resources, performance monitoring, and safeguarding the central government's tangible assets. The regulations apply to the office of the prime minister, the ministries and those subordinate institutions whose resource allocations are fixed in the government budget. They function as a general framework and allow the ministries and institutions sufficient room for individual adjustment.

The public administration in Norway does not use contracts in the rigid sense of the term. However, for certain purposes written documentation is used, outlining requirements and limitations for the work to be done. This case study describes two such arrangements: the *letter of allocation* and the *top management salary contract*. Each, in its own way, illustrates how this type of co-operation works. These documents are fundamental in the management dialogue between the ministries and their subordinate agencies, and are closely associated with the ministers' constitutional responsibilities. It varies whether or not they can be viewed as legally binding documents. The content of the various documents is often the result of a dialogue between the ministry and subordinate agency in question. However, once the content is formalised in a document, it assumes the guise of an order from the ministry.

The *letter of allocation* encapsulates and formalises the ministries' control of subordinate agencies. The letter of allocation defines subordinate agencies' resource allocation and associated performance requirements and reporting routines. The resource allocation is made by the *Storting* through the government budget, and the performance requirements of government are also based on general objectives and performance requirements established by the *Storting*. As part of this budget and performance setting process, an estimated 300 different letters of allocation are drawn up and transmitted to a broad range of subordinate agencies. They are normally signed at senior ministry level (secretary general or director general) but a minister can also sign them. The letter of allocation contains instructions to subordinate agencies regarding what the ministry expects and requires them to implement and achieve within the budget framework at their disposal.

*Top management salary contracts* were implemented in 1990 and revised in 1997. These contracts are usually set up between a ministry's highest official (secretary general) and the general directors of that ministry, the directors of subordinate agencies in question or the highest officials within the regional administration if they come under that particular ministry. They are individual contracts that define the tasks that the superior official or ministry sees as particularly important for the various managers. It is optional for managers to be part of this arrangement, although participation in the scheme is strongly encouraged. At present, approximately 280 managers have entered into a salary contract with his or her superior.

## **2. Letters of Allocation**

### ***Background***

Up until the beginning of the 1990s, the letter of allocation was the formal notice of the resource allocation for the budget year. When the government budget became increasingly goal- and performance-oriented at the start of the 1990s, the letter of allocation was regarded as an appropriate tool to use for the management of subordinate agencies. Today the letter of allocation is viewed as the main management document in the relationship between ministries and subordinate agencies.

Letters of allocation vary in their scope and degree of adaptation to individual agencies. A number of factors are involved, *inter alia* how management processes in the individual ministry are organised and co-ordinated. In some cases where a ministry has a number of "identical" subordinate agencies, it sends identically worded letters to each of the agencies. For example, this is the case for Norway's 54 police districts which come directly under the Ministry of Justice. In other cases, subordinate agencies receive management signals from several superior ministries. This can be seen, for example, in the case of the 18 county governors<sup>1</sup> who have six superior ministries, two of which sent their own letters of allocation until 1998. Beginning in 1998, the county governors now receive *one* co-ordinated letter of allocation from the Ministry of Labour and Government Administration. Letters of

allocation to the county governors usually comprise an identically worded section and a section tailored to the county in question. In another example, the social security administration answers to both the Ministry of Health and Social Affairs and the Ministry of Children and Family Affairs, each of which draws up and sends their own letter of allocation.

The superior ministry usually requires subordinate agencies to notify deviations in relation to planned objectives and/or expenditure as part of their reporting duty. Emphasis is often placed on rigorous budget discipline, on the fact that extra appropriations cannot be added, and that any excess consumption will be deducted from next year's budget, etc. However, reference is rarely made to sanctions beyond what is inherent in the delegated powers such as the power to transfer resources.

Beyond the ministry itself, it is primarily the Office of the Auditor General, the *Storting's* watchdog, which is responsible for monitoring and control of the executive branch (the ministers/ministries). The Office of the Auditor General reports to the *Storting*, whose Standing Committee on Scrutiny and Constitutional Affairs assesses and, if necessary, recommends sanctions by the *Storting*.

### *Main Focus*

The regulations on financial management in the government administration (the "Financial Regulations") require letters of allocation to focus on finances, performance requirements and reporting. Within its areas of responsibility each ministry is responsible for establishing goals and performance requirements to be realised within the framework of the adopted resource allocations without unauthorised overruns. Each ministry is also responsible for ensuring that performance reports are submitted in an appropriate manner. This also entails ensuring that methods and performance indicators/criteria are formulated which can be used to assess whether agencies' outcomes in a given period conform with requirements established, first by the *Storting* and at a more detailed level by each ministry.

The Financial Regulations do not give a precise definition of what is meant by *performance*. The term encompasses everything from a quantification of the agency's outputs to an assessment of the outcome of such outputs for concrete users and/or the community in general. *Qualitative* aspects are also incorporated in an agency's output.

### *Goal/Main Purpose of the Scheme*

A main purpose of selecting one document as the central management document is to ensure coherent management of subordinate agencies whereby goals and performance requirements are viewed in conjunction with budgetary limits and other framework conditions faced by the agency.

The Financial Regulations require annual management documents — i.e. the budget, letter of allocation, plan of operations/annual plan and annual report — to be formulated in such a way that their content forms a coherent whole. The documents are designed to be used as a basis for the oral management dialogue and to underpin internal management processes in a ministry and its subordinate agencies.

### *Description of the Scheme ("the Contract")*

According to the Financial Regulations, letters of allocation have to contain the following items:

- amounts allocated in each expenditure category and amounts to be earned in each revenue category;
- specification of general goals and making them concrete in the form of appropriate performance requirements, strategic challenges listed in order of importance, and, where appropriate, a statement of prioritised areas;
- statement of indicators to be used to assess performance and delineation of necessary follow-up and supervision of agencies/grant schemes;
- requirements as to appropriate reporting of annual results, including any supplementary information for use in connection with subsequent evaluations;
- notification of initiation of evaluations, if any; and
- an overview of administrative and budgetary authorisations.

The letter of allocation is, in principle, intended to make operational and validate the political management signals given in the annual Budget Proposition. It also must state the authorities and authorisations (financial and administrative) that have been delegated to the agency. This will vary widely, depending on the nature of the agency's affiliation to the central government, and its size, needs, history, administrative machinery, etc.

The Financial Regulations require the ministries to draw up and transmit *preliminary letters of allocation* to subordinate agencies once the Budget Proposition has been published. This is normally done in October. Preliminary letters of allocation promote two considerations. First, agencies have an opportunity to incorporate general focuses and priorities into their internal plans of operations, which are usually drawn up in the autumn preceding the start of the budget year. Second, agencies have an opportunity to comment on and put forward their own suggestions as to the content. This is important in order for the final letter of allocation to be the result of a process between the ministry in charge and the subordinate agency. The final letter of allocation is transmitted to the agencies as soon as the *Storting* has adopted final decisions on resource allocations — normally around the turn of the year.

Letters of allocation are addressed primarily to government administrative agencies, i.e. agencies directly responsible for exercising governmental authority (e.g. the tax administration and the Directorate of Immigration), distribution and grant administrations (e.g. the social security administration and the Norwegian Agency for Development Cooperation, NORAD), control and supervisory agencies (e.g. the Competition Authority, the Banking, Insurance and Securities Commission, the Labour Inspection and the county governors), production of hospital services e.g. (the National Hospital, *Rikshospitalet*), etc. All outputs and operational dispositions on the part of this type of subordinate agency are, in principle, the parliamentary and constitutional responsibility of the minister(s) in question. This is in contrast to state-owned companies and foundations, whose management is subject to other rules and where the minister has fewer operational and business responsibilities.

### ***Assessment of the Role and Function of Letters of Allocation***

It should be kept in mind that, in its present form, the letter of allocation is a relatively new management tool. The wording of the letter of allocation, and the process associated with it, are highly dependent on the Budget Proposition which has also undergone (and is still undergoing) a process of change.

The content of the letters of allocation varies widely. Some of them repeat large portions of the text of the Budget Proposition, with relatively little additional specification. This is due to several factors.

First, the text of the Budget Proposition may be so extensive and inclusive as to make it difficult for the ministry to specify the mandate further without imposing detailed controls. Second, efforts are being made to develop sound performance objectives, requirements and indicators. Issues of performance specification and indicators of success are of particular concern in public policies and programmes where, for example, the effects will only be evident at some time in the future, where the cause-effect relationships are complicated, or where the agency's contributions only represent a minor portion of the final outcomes.

Performance requirements in relation to NORAD are a good example of these specification and measurement challenges. General goals in the field of development aid include contributing to the reduction of poverty and destitution. NORAD administers grants which are mediated via a number of different channels to development aid projects worldwide. As a rule, Norway's contribution comprises an extremely small share of total development aid. In many instances, Norwegian funds are also channelled via international organisations, providing little opportunity to follow the funds to their final outcomes.

Other letters of allocation are more concrete in relation to particular areas and tasks. The reason may be in part that the ministry has a special interest in these areas and in monitoring them, and in part that it is precisely in these areas that it is easiest to be concrete regarding specification and measurement. As regards service provision and activities that are more production-oriented, it has become increasingly common to impose productivity requirements (in terms of case-handling time, number of patients or the like) such as in letters of allocation to the tax administration, social security administration, and hospitals. Work on developing sound reporting requirements and routines in relation to quality and outcomes is continuing in these areas.

Many subordinate agencies express the general view that there is a tendency towards detailed control of finances and administration: reporting requirements are generally more precise and detailed in these areas. The extent of each ministry's control of agencies' internal systems varies. Some agencies with little or no financial management are controlled more rigorously than others.

The overviews of administrative and budgetary authorisations set out in the letters of allocation help to clarify responsibilities. To the extent that the ministry formulates concrete assignments and requests or instructs a subordinate agency to assume responsibility for specific areas or tasks, the division of roles and responsibilities between various levels becomes even clearer. Aside from this, the actual process associated with the wording of the letter of allocation and its framework is viewed as more important than the letter of allocation itself, when it comes to clarifying roles and responsibilities. However, the letter of allocation does represent a formal transfer of authorisations and may therefore play a role in the parliamentary context.

For most agencies, the letter of allocation nowadays constitutes a formalisation and documentation of political, administrative and sectoral management signals from a higher level. Other parts of the management dialogue (agency management meetings, formal and informal approaches and discussions, etc.) as well as the transmittal of preliminary letters of allocation, mean that management signals set out in the official letter of allocation are known in advance and are largely incorporated in the agencies' internal plans. The content has, to a greater or lesser degree, been the object of a process between the ministry and the agency in question, especially where sectoral performance requirements are concerned.

It is relatively rare for the ministry to discuss measuring methods explicitly in a letter of allocation. However, it is normal that the ministry requests subordinate agencies to develop indicators and systems that make current and annual reporting possible.

For the ministry's part, strategic management is provided through the Budget Proposition, other propositions and reports to the *Storting*, as well as through various types of government studies. Many agencies prepare strategic plans, but these have no formal status in relation to the letter of allocation and management dialogue between the ministry and the subordinate agency. Letters of allocation cannot be said to play a strategic role in the relationship between the ministry and the subordinate agency. The letter of allocation is primarily targeted at day-to-day management. They can, however, formalise the conclusion of a strategic process.

Moreover, virtually no incentives or sanctions are attached to the actual letter of allocation. Subordinate agencies normally receive no reward if performance and reporting requirements are more than met. Although the ministries themselves rarely use sanctions in a punitive way, a shift in the direction of closer and more detailed management by the ministry may be interpreted as a sanction. In very exceptional cases, a ministry may place a subordinate agency under its direct administration. Moreover, agencies with a high degree of goal achievement may have their financial allocation correspondingly reduced and may perceive such action as a sanction.

In recent years the letter of allocation with associated goal and performance requirements has increasingly formed the basis for agencies' interim and annual reporting.

### **3. Top Management Contract Scheme**

#### ***Background / description***

The top management contract scheme was introduced at about the same time as the scheme involving letters of allocation and the two processes have clear-cut links — although, formally speaking, they are independent schemes.

Central objectives of the top management contract scheme originally were:

- to make central government competitive on the labour market, enabling state enterprises to recruit and retain accomplished managers;
- to increase manager mobility between the private and public sectors; and
- to facilitate the imposition of clear-cut performance requirements on the top managers along with the introduction of fixed monitoring routines.

The top management contract scheme was introduced when the central negotiating parties to the state sector wage settlement in 1990 agreed to remove the top managerial positions from the state pay scale and remunerate them on a contractual basis using performance-based pay. The contract would be based on an administrative assessment of factors such as the nature, complexity, market exposure of each post, and an annual evaluation of each manager's performance. The performance assessment included a bonus scheme offering the possibility of personal increments of up to 20 per cent of the basic salary. Hence the scheme embraces both a pay-level element and a performance-related element.

When the scheme was introduced in 1996, approximately 370 managerial contracts were entered into, distributed across four pay categories/levels. Director generals (numbering approximately 100) at the ministries make up the biggest grouping of managers in the scheme. Other large groups participating in the scheme are managers of executive agencies and the county governors. Up until 1996, personal increments were mainly awarded in the financial sector and the transport and communications sector, which have been the sectors most exposed to wage competition from the private sector.

A model for drafting legally binding employment contracts and a guide for the annual performance-related contracts have been drawn up. The link to performance-related pay is specified in the employment contract.

The introduction of the scheme coincided with the government's need to conduct a moderate incomes policy involving modest wage increments as part of the so-called "solidarity alternative". Therefore, in its initial years, the scheme was subject to firm centralised control by the Ministry of Government Administration, both as regards stipulation of pay levels and levels of increments.

In 1997, the scheme was comprehensively revised — mainly because centralised control proved insufficiently flexible and burdensome as a pay system and gave insufficient encouragement to the development of local performance evaluations.

The revised scheme contained the following main elements:

- Approximately 90 top managers were taken out of the scheme and returned to the central government pay scale.
- The number of main salary categories was raised from 4 to 5, each with two sub-categories, resulting in three pay levels within each main category.
- The right to award 20 per cent personal increments was retained, but was reserved mainly as an instrument for performance-related pay and less as an instrument to counter wage competition from the private sector.
- The scheme for annual evaluation interviews and renewal of performance-related contracts was retained.
- The Ministry of National Planning and Coordination (currently the Ministry of Government Administration and Labour) retained authority to approve the placement of managerial positions in the main category, while authority to award increments in the form of placement in a sub-category and within the 20 per cent scheme was delegated to all ministries. As a result, each ministry was enabled to make adjustments both in the level to which a post was assigned and in relation to wage competition and as a performance-pay element.
- The Ministry of Planning established a Contact Forum for salary and personnel officers at the ministries in order to harmonise the use of the new powers, develop joint criteria and tools for assessments of positions and performance, and exchange experience.

### ***Assessment of the Top Management Contract Scheme and Central Issues***

#### *Assessment of the Top Management Contract Scheme*

Despite its restricted use, the top management contract scheme has made some contributions to the enlistment and retention of accomplished managers. A number of areas still show low recruitment levels and few losses to the private sector and are therefore less exposed to wage competition. On the other hand, the objective of increased manager mobility has not been achieved.

The Contact Forum for salary and personnel officers has already become an important tool in developing the top management contract scheme. The forum bases its work on the assumption that it is extremely difficult to arrive at criteria which are precise and applicable to all conditions which may be present in the various sectors where the top management contract scheme is to be used. Hence an

element of discretion will invariably be present. The quality of assessments is considerably enhanced if checklists and standardised criteria are available. For this reason, the forum has emphasised, on the one hand, the need for meaningful and impartial assessment and, on the other hand, the need to formulate standardised guidelines for the assessment process.

### *Central Issues*

It remains to be seen whether the revised scheme entailing greater flexibility in terms of pay levels, etc., will make for improved outcomes in terms of wage competitiveness and manager mobility. The trend in managerial salaries in the private sector, where a tendency for steep increases seems to be in evidence, will be crucial.

Other aspects of the top management contract scheme, however, are not affected to the same extent by external conditions and appear to show good development potential. In a poll of top managers, for example, many respondents report that they support the scheme because it represents a fixed routine for evaluating and discussing their own performance.

Members of the Contact Forum also view the scheme as a channel of influence through which requirements for good management can be emphasised and specified; this holds out promising perspectives for management development in the central government administration.

Developing the content of performance-related contracts will occupy the centre stage in the period ahead both in terms of arriving at good performance and outcome indicators and of managing priorities. The guidelines outlined by the Contact Forum entail wide freedom of action for the individual ministry in this respect. As experience is gained, a more normative approach in this area may be possible.

Performance reporting is a central element of the scheme. In connection with the scheme of letters of allocation and agency management, a recommended pattern has already been established for the central government administration entailing three regular reporting meetings between the individual ministry and its subordinate agencies. A great deal of current performance information on technical issues will be transmitted between ministries and their external agencies via this channel and an extensive network of contacts.

A scheme also exists involving evaluation interviews for managers on performance-related contracts and managers' own self-evaluations, available prior to the evaluation interview. Here a special focus can be directed at those performance areas that the individual ministry has chosen to include in the performance-related contract with the individual manager. As previously mentioned, the Contact Forum has so far avoided laying down normative guidelines for what types of performance areas should be incorporated in performance-related contracts — apart from the emphasising that principles of good leadership should receive heavy emphasis.

## **4. The Connection Between the Various Management Processes**

Co-ordination of the various elements of the performance management process is an essential condition for success. For example, knowledge of the effects of the different instruments is a fundamental premise for the work on the budget. This entails a need to co-ordinate the processes associated with the definition of goal and performance requirements in relation to the budget process, and to ensure that performance reporting is given a structure that enables it to play a useful part in the work on the budget.

Thus far there has not been a formalised connection between the letter of allocation and the top management contract scheme. For instance, it is not necessarily the same person who signs the letter of allocation and the management contract, or who takes part in the agency management meetings and the evaluation interviews. Norway is facing several challenges in management and co-ordination of these performance tools.

A key area of development is the creation of a coherent timeframe for budgets, letters of allocation, managerial contracts, performance reporting and evaluation interviews so as to ensure a purposeful evaluation period. A question raised in this connection is whether evaluation interviews should be assigned to the start or to the end of the year.

For some agencies (e.g. the county governors), a further problem is that they receive letters of allocation from several ministries, whereas performance-related contracts are entered into with the Ministry of Government Administration. In order to bring about a good performance evaluation it is important for ministries to assemble and co-ordinate all relevant internal performance information — information which is often dispersed across various departments and sectors. The top management contract scheme must therefore be put on a broad footing and not become an isolated, administrative pay system outside the broader performance context.

As regards the relationship between letters of allocation and performance-related contracts, the ministries must make a concrete choice as to which performance areas should be covered in the letter of allocation, and which ones in the performance contract, and how much overlap is desired between these two systems.

It is of course simpler to arrive at sound performance and outcome indicators for central government agencies which produce directly measurable outputs than it is for agencies which produce both outputs and exercise governmental authority, and which, in many cases, have to work in an indirect manner.

A central issue both for the content of performance-related contracts and reporting is to arrive at a manageable number of performance areas and indicators so as to ensure that the schemes involving letters of allocation and performance contracts will promote sufficiently transparent management and dialogue systems. Developments in this area will be crucial for the schemes' success. This is important, not least because the top management contract scheme opens the way for managers on contract to employ performance-related contracts vis-à-vis their subordinate managers, but without the same formal legal basis. This trend is already under way in some instances.

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<sup>1</sup>. The main representatives of central government in the counties are the county governors whose major administrative responsibilities are agricultural and environmental affairs. In addition, they have departments for social and family affairs and civil defence. Furthermore, they are responsible for executing central government policy in the counties, supervising the municipalities and handling complaints on decisions made at the municipal level.