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**Determining the Structure and Functions of Government:  
Program and Functional Reviews**

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**Administrative Reform : Determining the Structure and Functions of Government : Program and Functional Reviews**

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## **I : Introduction**

This background paper presents an assessment of international approaches to and experiences of undertaking program and functional reviews as part of an administrative reform program. The paper examines program and functional reviews drawn from twenty five examples from fourteen different countries (examined in detail in Appendix 1).

The first section of this paper provides an overview of international experience of and approaches to program and functional reviews in government. The second section provides examples of the specific approaches and methodologies used in the most common types of program and functional reviews. The third section seeks to define an appropriate methodology for undertaking such reviews in Russia as part of the developing administrative reform program taking account both of the context and needs in Russia and of international experience in this area.

## **II : International Experience of Program and Functional Reviews**

### *Countries and functional review experience examined*

The comparative analysis in this chapter is derived from assessment of the following international examples of program and functional reviews:

**Brazil** – Inventory of Government programs

**Canadian reviews:**

Government of **Canada** – 1994 program review

Government of **Canada** – ongoing Alternative Service Delivery reviews

Canada : Province of **Alberta** – ongoing Alternative Service Delivery reviews

Canada : Province of **Manitoba** – ongoing Alternative Service Delivery reviews

Canada : Province of **New Brunswick** – Program and Service Review

Canada : Province of **Ontario** – ongoing Alternative Service Delivery reviews

Canada : Province of **Quebec** – Autonomous Service Unit Program

Canada : City of **Winnipeg** – Management Reference Model reviews

**Jamaica** – agency modernization diagnostic reviews

**Jordan** – functional review of the Department of Administrative Development

**Kazakhstan** – 1998 functional review

**Latvia** – 1999 functional review of the Ministry of Agriculture

**Macedonia** – 2001 wagebill reduction review

**New Zealand** – reviews of the State Sector

**Nicaragua** – structure and function diagnoses

**Papua New Guinea** – functional reviews

**Tanzania reviews:**

**Tanzania** : Review for agency status

**Tanzania** : Organization and efficiency reviews

**Thailand** – 2000 functional reviews

**UK reviews:**

**UK** : Prior Options reviews

**UK** : Better Quality Services and Best Value Reviews

**UK** : Market Testing

**UK** : Fundamental Expenditure reviews

**USA** – Bottom up review of the Department of Defense

A summary assessment of each of the above exercises is set out in Appendix 1.

### *Objectives of functional reviews*

Reform teams in governments have launched program and functional reviews for a number of reasons. The most common has been in response to fiscal pressures, with the reviews being designed explicitly from the outset to identify sometimes significant savings. Others have been designed in response to pressure from political leaders wishing to increase the policy responsiveness of the government machine and to strengthen the effectiveness with which policies are translated into actions and outcomes. Others have been driven at least in part by a desire to respond to pressures from either the private sector or citizens for better and more appropriate services.

Reviews can focus on two different subjects for potential reform: **organizational** and **policy**. Organizationally, reviews can identify individual Ministries, agencies or work units that are to be restructured for cost-effectiveness, effectiveness, and/or efficiency reasons. In terms of policy, reviews can require that all government policies and programs be considered, or can focus on specific policy areas or programs felt to require particular attention or to be particularly problematic.

A narrow review focus on how a set of organizations is structured and managed, without any attempt to review the policies that they are asked to implement, is a **classical review of operational efficiency**. The question in this case is: "**how can we reduce running costs or improve service quality while delivering these programs?**" Conversely, a focus on government policy and programs without any concern to review the organizational arrangements that deliver them represents a **'pure' effectiveness study of policies and programs**. The question in this case is : "**what are we best at doing?**"

These different approaches are of course related. Operational efficiency and program effectiveness are inextricably linked. What governments *should* do is inevitably linked to the question of what they *can* do well. However, the linkage is not mechanical and in undertaking efficiency and effectiveness reviews, different governments have made different choices at different times, with varying degrees of specificity regarding which organizations and which policies they are concerned about.

### ***Typology of program and functional reviews***

There are five main types of program and functional reviews (see Figure 1). As the figure suggests, there are many possible different approaches and combinations, but the basic picture is of five different types of reviews, which can be shown to have increasingly narrow concerns:

#### **1. 'Pure' policy or program reviews**

*Description:*

These reviews aim at securing comprehensive policy reforms, with low priority programs being dropped and resources and efforts targeted at higher priorities. The reviews tend not to get into detailed organizational level arrangements, prescribe detailed restructuring, or identify changes at the level of business processes.

*Typical applications:*

Many efforts to define (or re-define) the government sector in transition economies fall within this category. Reviews in preparation for the divestiture of non-core activities and ceasing non-government functions, including the review of agencies/SoEs for closure/privatization, fall within this category, with the consequent organizational restructuring being incidental to the larger objective of elimination of non-priority programs.

*Examples:*

- Brazil – inventory of government programs
- Government of Canada – 1994 program review
- Kazakhstan – 1998 functional review

## **2. 'Pure' efficiency reviews**

*Description:*

This type of review envisages no major changes in government policies and programs, but focuses instead on identifying organizational and business process changes which can generate the same outputs at greater efficiency.

*Typical applications:*

The reviews can be fiscal-driven and undertaken with a view to introducing hiring and wage freezes and base pay reductions or across the board staff cuts and early retirements. Such reviews can also be undertaken in preparation for securing from Ministries/agencies annual efficiency targets.

*Examples:*

- Macedonia – 2001 wage bill reduction review

## **3. Upstream program and efficiency review**

*Description:*

This type of review envisages comprehensive policy reforms, including a shifting from low to high priority programs, together with the restructuring of government-wide processes including large scale restructuring of the machinery of government.

*Typical applications:*

In New Zealand the reviews were strikingly top down, centralized, and expert-driven. Political ownership and conceptual rigor were the hallmarks. Buy-in from the wider public sector came later and there were relatively few attempts at broad participation during the process.

*Examples:*

- New Zealand – reviews of the State Sector

## **4. Mainstream ministry/agency-level functional review**

*Description:*

These reviews consider reshaping some programs, dropping some activities, and restructuring some entire Ministries/agencies but without large scale changes to the overall machinery of government.

*Typical applications:*

Such reviews can focus on the elimination of duplication, the consolidation of similar services, and the merger of similar functions/units from different ministries/agencies. These reviews tend to be based on a clear methodology/criteria for the reviews set by the center of government (Cabinet Office, Ministry of Finance), and are generally undertaken by teams including representatives from center of government bodies, the Ministry/agency under review, together with external experts or consultants. There appears to be broad international experience of developing and implementing such programs of reviews.

*Examples:*

- Canadian reviews: Government of Canada – ongoing Alternative Service Delivery reviews; Province of Alberta – Alternative Service Delivery reviews; Province of Manitoba – Alternative Service Delivery reviews; Province of New Brunswick – Program and Service Review; Province of Ontario – ongoing Alternative Service Delivery reviews; City of Winnipeg – Management Reference Model reviews
- Latvia – 1999 functional review of the Ministry of Agriculture
- Nicaragua – structure and function diagnoses
- Papua New Guinea – functional reviews
- Tanzania reviews: Organization and efficiency reviews
- Thailand – 2000 functional reviews
- UK reviews: Fundamental Expenditure Reviews; Better Quality Services and Best Value Reviews
- US reviews: 'Bottom Up' review of the Department of Defense

**5. Downstream organizational reviews and business process re-engineering**

*Description:*

These entail dropping or changing specific activities and services within a specific Ministry/agency, or the detailed restructuring of a specific agency.

*Typical applications:*

These reviews would tend to focus on the consolidation of similar services within the same ministry or agency, and could include pursuing options such as automation and contracting out or market testing (the introduction of competition in the provision of administrative services).

*Examples:*

- Canadian reviews: Province of Quebec – Autonomous Service Unit program
- Jamaica – agency modernization diagnostic reviews
- Tanzania reviews: Review for agency status
- UK reviews: Prior Options reviews; Market Testing

**Figure 1 Choices for the review focus**

		<b>Organizational level focus – efficiency concerns ("running costs", service quality)</b>			
		No organizational efficiency improvements sought	Whole of government efficiency improvements sought	Ministry or agency	Sub-units
<b>Policy and program level focus – effectiveness concerns ("policy costs", outcomes)</b>	No effectiveness improvements sought		'pure' efficiency savings sought		
	Effectiveness improvements sought comprehensively or in groups of programs	'pure' policy or program reforms sought	upstream program and efficiency reviews		
	Individual programs, government-wide activities			<b>mainstream</b> Ministry/agency-level functional reviews	
	Specific activities and services			<b>downstream</b> activity and organizational reviews and BPR	

***Aligning functional reviews with the budget process***

The defining characteristic of efficiency and effectiveness reviews is that they entail a discrete approach for developing recommendations for change outside of the usual budget and planning cycle. However, clearly the results of the review must ultimately be incorporated within the budget. Reviews will not lead to concrete outcomes if central government bodies are in the position of suggesting reforms that they have neither the budgetary information to fully justify nor the leverage to fully implement. Reviews may also lead to disappointing outcomes if they identify areas in which legislative change is required, but do not assess the feasibility of securing such changes. Finally, there is a significant risk of mis-timing if the Ministry of Finance/Budget Office is provided with recommendations at an inappropriate point in the budget cycle.

Budget comprehensiveness

## Determining the Structure and Functions of Government : Program and Functional Reviews

Upstream and mainstream reviews are generally dealing with more than one administrative unit (ministries/agencies). In reviewing entire programs, or in focusing on ministries and their subordinate bodies, such reviews look at all the bodies that contribute to a program and may propose a reallocation of resources between and within them. This is based on the assumption that ministries both have information on the activities of their subordinate bodies, and also have authority in enforcing changes in structure and in priorities.

That information and that authority to enforce change derive significantly from the budget. When some revenues and expenditures are off-budget, the parent ministry may have no detailed knowledge of their activities and therefore has limited ability to enforce change as the subordinate body has effective autonomy. Off-budget cost-recovery mechanisms can exacerbate this problem significantly. When fiscal pressures encourage public agencies to finance their operations through off-budget user charges, the consequence is again that agencies have few incentives to respond to the requests for rationalization or policy change from their supervising ministry.

### Flexibility in Ministry/agency mandates

One contributory factor in the intermittent successes of efficiency and effectiveness reviews in OECD countries has been that the legal mandates of the Ministries/agencies and programs have been flexible, or have been changed in step with the review process. The Government of Canada – 1994 program review and the Better Quality Services and Best Value Reviews in the UK have required comparatively few legal changes : it is largely within the authority of the relevant ministers to amend the structure of the executive bodies and to simply cease provision of some services.<sup>1</sup>

In other European and Latin American administrative traditions, the situation is very different. In those contexts, efficiency and effectiveness reviews must therefore take account of the fact that significant program changes will require legislation to be enacted or amended, with all the accompanying uncertainties thereby entailed.

### Coordination with the budget cycle

*Upstream* program reviews would shape the entire budget process, with reductions in the budget envelopes available to the spending ministers announced at the *start* of the budget cycle. *Mainstream* functional and agency reviews have their impact *during* the budget cycle. For these reviews, the selected ministries/agencies must offer up their proposed rationalization plans following the distribution of the budget guidelines. In some, largely Parliamentary, settings it is reasonable to assume that ministries/agencies will accept the discipline of the review process and would submit a radically reduced budget submission based on the review. In other settings it is more probable that the Ministry of Finance/Budget Office would take the lead in proposing a new budget estimate based on the completed review findings.

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<sup>1</sup> The reforms to the intergovernmental fiscal transfers were of course an exception to this and required significant legislative change (Tupper 1996).

The key issue is timing. If a realistic timetable for a comprehensive review is perhaps 6 months, then this requires that they are started this much in advance of the final budget reconciliation undertaken by the Ministry of Finance/Budget Office. Missing this window will leave the Ministry of Finance/Budget Office with a series of unenviable choices. They can either restructure the estimates based on little more than guesswork. Alternatively they can wait a further year before the data from the review can be utilized. Finally, they can of course seek a budget amendment, with all the political risks and the central agency management time that initiating such a legislative amendment may entail.

***Formal evaluations of international functional review experience***

Of the international functional reviews examined, few have been the subjects of any systematic evaluation.

Of the *'pure' policy or program reviews*, the *Government of Canada – 1994 program review* has been extensively evaluated and generally the findings are very positive. See (Armit and Bourgault 1996; Aucoin and Savoie 1998; Auditor General of Canada 1998; Davis, Weller, Craswell and Eggins 1999; Mets 1995; Peters and Savoie 1998; Treasury Board of Canada Secretariat 2001). The evaluators note that the impact was impressive with budget savings of Cdn\$3.9 billion out of a total budget of Cdn\$52 billion in FY95/96, rising to savings of Cdn \$7.2 billion in FY 96/97. All this was achieved without strikes or other significant labor relations problems.

It is important to note that other program reviews have not had such positive outcomes. An earlier review in Canada, led by the Nielsen Task Force in the mid 1980s, led to a large number of volumes of reports being produced on the evaluation of departmental programs and policies, and on detailed recommendations for change. However, little demonstrable action was taken on this reform effort for several reasons. It was perhaps over-ambitious and overly concerned with efficiency savings rather than a clearly understood revision of the role of government. This may have led to some confusion between the policy and the institutional changes that it was recommending. Also, it was driven at the political level by a new government, with a strong suspicion that there was a hidden political agenda, reducing buy-in and commitment to change. Additionally, in that period of deficit financing in the 1980s, budget constraints were not felt to be particularly hard. The 1983 Grace Commission in the USA also had questionable impact.

Schick points out that successful program reviews probably owe their triumph more to the mood of the times than to any technical innovations. He notes that nearly every country that tried to build a formal program analysis and review system in the 1960-1990 period failed. "The Netherlands made little progress with a reconsideration effort that involved the Cabinet in selecting programs for reexamination; Sweden had little results from program budgeting, the United Kingdom installed and then discarded a program analysis and review system, the United States adopted an ambitious planning-programming-budgeting system, and other countries also introduced similar innovations." (Schick 1999, p. 7) He concludes that the reason for the many failures was that voters and politicians were not yet convinced of the compelling need to halt the growth in government spending and to reallocate resources from lower to higher priorities. "Although program reallocation still is

difficult, the political mood of the 1990s has been much more hospitable to efforts to rearrange government programs and expenditures than it was during the postwar growth spurt." Other reviews of broad program reviews have been less critical (OECD 1999).

Although the 1994 Program Review in Canada is referred to here as a 'pure' policy or program review, this is really a question of emphasis. That review also introduced a program of change in the machinery of government, with a major program of Special Operating Agencies initiated and many services contracted out to the private and not for profit sectors. These managerial reforms and efficiency improvements were however not the centerpiece of the reforms.

The *upstream program and efficiency review* undertaken in the *New Zealand – reviews of the State Sector* has also been extensively evaluated. See for example (Boston, Martin, Pallot and Walsh 1996; Manning 1995; Schick 1996). (Steering Group 1991) reported on the implementation of the comprehensive New Zealand reforms, noting in general terms that the accountability arrangements had withstood the shock of change fairly well. The review used interviews with ministers, group interviews, and a survey of chief executives, supplemented by case studies. Most recently (Boston 2000) reported that the outcome was unclear, but the tenor of the evaluation was positive.

The South African Presidential Review Commission can also perhaps be included in this category, but no evaluation is available (The Presidential Review Commission 1998).

The *mainstream Ministry/agency-level functional reviews* undertaken in the *Latvia – 1999 functional review of the Ministry of Agriculture* and the US *'Bottom Up' review of the Department of Defense* were both reviewed in varying depths. The Latvia review was followed by an assessment by an independent consultant that found that the recommendations of the review had been well implemented, although there had not been sufficient time to evaluate the impact (István 2000). The General Accounting Office comprehensively evaluated the US review (General Accounting Office 1995). It found that the Department of Defense incorporated unsubstantiated assumptions about the availability of forces, supporting capabilities, and enhancements that it concluded were necessary.

A recent evaluation of the UK Best Value pilot reviews in local government noted that the processes required to undertake the reviews were challenging but achievable, and that there was significant externalities as staff learned more about innovations in other authorities. Service delivery and efficiency improvements were reported to be patchy and not statistically significant, but nevertheless some were identified.

No comprehensive evaluations of the *'pure' efficiency reviews* or of *downstream organizational reviews and business process re-engineering* were identified. Initial results from Macedonia on the impact of the review there suggest that progress towards substantial efficiency savings has been limited.

There is remarkably little data available on the costs of reviews. The evaluation of the UK Best Value pilot reviews noted that only half of the responsible managers felt that

the subsequent savings would recoup the costs of the reviews (Department of Environment 2001). However, it is not clear whether this is an accurate prediction of the actual costs and benefits.

***What determines the type of review?***

Overall, it seems that efficiency and effectiveness reviews are undertaken not because there is a large body of knowledge confirming that they do in fact lead to measurable and sustainable improvements in either efficiency or effectiveness. If therefore they are undertaken more in hope than in certainty, the question arises what is driving them. It is self-evident that fiscal pressures provide the broad context, accompanied by a renewed quest for legitimacy by (at least OECD) governments. The shape of the reviews undertaken in particular countries is driven by the idiosyncrasies of the local political economy, but a few triggers stand out.

On the basis of the limited evidence provided by the reviews identified in Appendix 1, it seems that ***'pure' policy or program reviews*** are associated with some de-legitimization of the usual policy process. Brazil and Canada both have had, historically, well-recognized problems in aggregate fiscal discipline and there is a significant constituency within government that considers that bottom-up pressures are not adequately countered by top down restraints. See, for example, (Kelly 2000) who points out that when Canadian governments possessed the political will to attempt expenditure restraint they rarely also had the political capacity to give effect to these good intentions. (Alesina, Hausmann, Hommes and Stein 1999) point out the finely balanced nature of the institutional arrangements in Brazil, falling half way between collegial and hierarchical.<sup>2</sup> A review of policy, outside of the usual institutional constraints, becomes a rational strategy.

In Brazil there was a fear that covert political resistance within the bureaucracy would derail any specific reform targets – and so they selected a 'pure' policy review based on an information trawl without targets. Canada, by contrast, could manage the discipline within the public sector and specified clear quantitative targets for the policy review.

The Macedonia ***'pure' efficiency review*** was a direct product of donor encouragement. The Government of Macedonia agreed with the IMF to reduce the central government 2001 wage bill significantly, and to cap the total salaries paid from 'special' (off-budget) revenues. The agreed reduction in the wage bill was designed to lead to staff reductions in the central administration of up to 6,000 staff in 2001. The World Bank developed a methodology that it offered to the Government of Macedonia to meet the agreement without impairing the government's ability to deliver necessary policy reforms.

The New Zealand ***upstream program and efficiency*** review reflects the presence of a remarkably strong central agency (Treasury) with excellent connections within a

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<sup>2</sup> “Hierarchical” procedures imply ex ante constraints on the size of deficits, adopt top bottom voting procedures and are transparent. “Collegial” refers to procedures that have the opposite characteristics.

relatively small business and professional community and with a remarkably coherent set of political and ideological positions (Lowe and Roper 1996).

There seems to be varying forces driving the *mainstream Ministry/agency-level functional reviews*. The US example seemingly reflects, at least in part, a defensive maneuver on the part of the department concerned, wanting to head off anticipated funding difficulties. All of these types of review are however undoubtedly stimulated by the widespread perception that new management technologies and approaches are enabling improvements in operational efficiency. The Canadian 'alternative service delivery' reviews have the strongest ideological connotations, with a sense that there is a new set of ideas whose time has come.<sup>3</sup>

*A summary of the choices*

Figure 2 provides a summary of the types of reviews identified in this paper. Appendix 1 lists the country examples.

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<sup>3</sup> It is important to keep in mind that recent research on comparative reforms discredits any notion that there is a single, first-best model towards which OECD public sector management arrangements are relentlessly tending. See for example (Pollitt and Bouckaert 2000).

**Figure 2 Distinctive features of efficiency and effectiveness reviews**

	<b>'Pure' policy or program reviews</b>	<b>'Pure' efficiency reviews</b>	<b>Upstream program and efficiency review</b>	<b>Mainstream Ministry/agency level functional review</b>	<b>Downstream organizational reviews and business process re-engineering</b>
<b>Reviewing what?</b>	Broad policies and major government programs	Organizational and business processes across government	Major policies and programs; government-wide processes; machinery of government.	Specific programs, and the organizational structure of Ministries or larger Departments	Specific activities and services, and the structure of smaller agencies
<b>Budget comprehensiveness</b>	Critical			Important	Less important
<b>Coordination with the budget cycle</b>	Changes in the budget envelopes available to the spending ministers announced at the start of the budget cycle	Selected ministries must offer up their proposed rationalization plans following the distribution of the budget guidelines			
<b>Drivers of the reviews</b>	De-legitimization of the usual policy process	Donor encouragement	Strong central agency and coherent set of political and ideological positions	Not clear	Not clear
<b>"Successes"</b>	Government of Canada – 1994 program review	?	New Zealand – reviews of the State Sector	Latvia – 1999 functional review of the Ministry of Agriculture UK reviews: Better Quality Services and Best Value Reviews	?

### **III : Designing and Implementing Program and Functional Reviews**

This section focuses on the three most widely used types of reviews:

- **'Pure' policy or program reviews** - envisaging comprehensive policy reforms, with only a passing interest in organizational level arrangements
- **'Pure' efficiency reviews** - envisaging no major changes in government policies and programs, but assuming that organizational and business process changes can generate the same outputs at greater efficiency
- **Mainstream Ministry/agency-level functional reviews** – considering the reshaping of some programs, the dropping of some activities, and the restructuring of some entire Ministries/agencies but without large scale changes to the overall structure or machinery of government.

Reviews are aids to management judgment – not mechanical devices that automatically lead to a single best solution. They comprise two principal elements:

- The organizational processes for managing the review and for disseminating the results; and
- The 'decision trees' that encapsulate the rules, priorities and criteria for the review.

The "decision trees" represent a method for conveying succinctly the complex assumptions and criteria that drive reviews – the source of their critiques of existing policies and organizational structures. The principles and assumptions which underlie the generic decision trees presented and discussed in this section are explored in some detail in Appendix 2.

#### ***'Pure' policy or program reviews***

##### Key elements of the process

The following key steps were involved in the Canadian program review exercise (Kroeger 1998):

1. There was an initiating explicit commitment by the political party to reduce the budget deficit to 3% of GDP;
2. That commitment was reconfirmed in the 'throne speech' undertaking that election promises would be implemented (February 1994);<sup>4</sup>
3. A coordinating Minister was appointed (February 1994);
4. A special committee of ministers was created to manage the review;
5. Program evaluation criteria were set out (February – June 1994);
6. Notional targets for each Ministry were developed in bilateral discussion with the Privy Council Office;<sup>5</sup>
7. Ministries worked on their proposals and the coordinating Minister met with sector Ministers with repeated bilateral discussions (May – August 1994)

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<sup>4</sup> The speech from the throne is the term used for the opening of Parliament by the Governor General in Canada.

<sup>5</sup> Equivalent to Cabinet Office or Chancellery.

8. Strategic plans prepared by Ministers and submitted to a secretariat established in the Privy Council Office that reviewed them prior to presenting them to a committee of senior officials<sup>6</sup> chaired by the head of the civil service<sup>7</sup> that shadowed the committee of ministers;
9. Following comments from the committee of senior officials, revised plans were presented to the committee of Ministers and a second round of negotiations commenced;
10. Further reports were presented by Ministers that examined particular problems and 'horizontal' (coordinating) issues that had emerged during the first round;
11. The coordinating Minister presented final report to cabinet (January – February 1995);
12. The final report was presented to the Prime Minister and results incorporated into budget preparation by Ministry of Finance (February 1995);
13. Implementation was over a realistic 3-year period;

The special committee of Ministers that was created to manage the review provided strong central leadership, and disseminated a challenging but clear set of criteria for reviewing policies with explicit criteria for reviewing programs and with initial targets specified top-down for each major spending program. The process provided encouragement for flexibility and ingenuity in proposing solutions to reach those targets – allowing bottom up identification of the appropriate response.

Public expectations were managed, with explicit concern being generated by central and provincial government concerning the size of the deficit and Canada's future prospects. In retrospect it is clear that politicians took a significant risk in emphasizing to the public the dangers of doing nothing. This tactic helped the public see an advantage in otherwise painful reforms, but it could have generated a backlash against the very government that was attempting to introduce them.

Although high profile, the process deliberately avoided public debate on technical design of the reform programs. It was transparent within the public sector however, with extensive involvement from all senior staff. The committee of ministers was at pains to point out that **all** government policies were being reviewed, including those implemented by the central agencies. At the insistence of the head of the civil service, the central agencies each took a 15% reduction in their staffing. There was a widespread recognition that the central agency drivers of the process could not themselves escape from the pressures faced by their service-providing colleagues.

Focus was maintained by the frequent repetition of a set of guidelines, frequently included in ministerial speeches and widely distributed to all departments.

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<sup>6</sup> "Deputy Ministers" in the Canadian term, although this can be a confusing label as they are career civil servants.

<sup>7</sup> The 'Clerk of the Privy Council', also a career civil servant.

**Box 1 Criteria for program review**

- Does the program area of activity continue to service a public interest?
- Is there a legitimate and necessary role for government in this program area or activity?
- Is the current role of the federal government appropriate or is the program a candidate for realignment with the provinces?
- What activities could be transferred in whole or in part to the private or voluntary sector?
- If the program or activity continues, how could its efficiency be improved?
- Is the resultant package of programs and activities affordable within the fiscal restraint? If not, what programs or activities should be abandoned?

source: (Kroeger 1998, p. 17)

The review was accompanied by some complex changes in Canada's already intricate system of intergovernmental relations, with many transfers from the federal to provincial governments consolidated. Although the review included an explicit focus on jurisdictional alignment, some commentators have questioned the volume of responsibilities that were actually transferred.

Decision trees used

Drawing significantly on the Canadian example, the primary decision tree employed in program review provides guidance to departments and ministries on selecting programs that can be restructured or closed. It starts from the position that they should disaggregate the programs for which they are responsible into some coherent elements, and then by applying the criteria set out by the committee of ministers, determine which programs are promising candidates for restructuring or closure.<sup>8</sup>

It is important to note the range of policies and programs that can be covered by program reviews. Efficiency and effectiveness reviews do not claim to examine every area of government policy.<sup>9</sup> For example, they do not look at:

1. Macroeconomic policy (monetary policy, including exchange rate, interest rate or financial sector policies);
2. Overall fiscal policy (aggregate expenditure policy, tax policy and treasury management policy)
3. Trade policy (tariff, quota, subsidy and regulatory policies)
4. Labor market and industrial policy (wage policy, social security policy and labor standards).

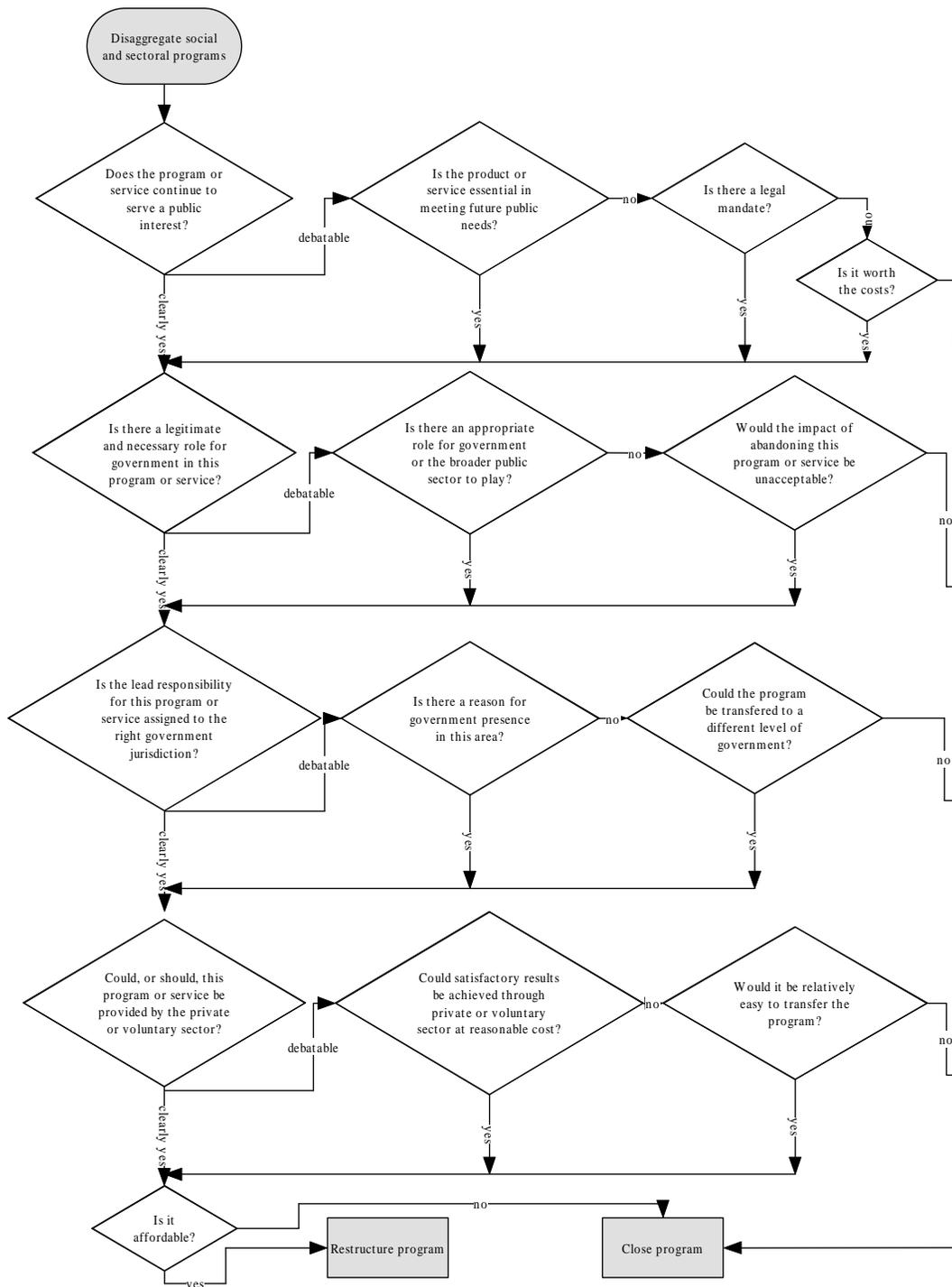
Program reviews focus on social and sectoral policy programs, and very particularly key social policy programs. This, of course, accounts for the majority of budget expenditure.

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<sup>8</sup> There is also an extensive literature on program reviews within higher education. This refers to the comprehensive and systematic reviews of academic programs. There is some comparison with the narrower functional and agency reviews, but little of relevance for this larger review of government programs. See (Mets 1995).

<sup>9</sup> (Evans and Manning 2001) provides a summary of the ways in which policies and programs can be classified.

**Decision tree 1 Identifying programs for restructuring or closure**



Sources: Authors, derived from (Wilkins 2001) and see Appendix 2: *Critiquing social and sectoral programs*

*'Pure' efficiency reviews*

Key elements of the process

In Macedonia, the World Bank developed a methodology that it offered to the Government of Macedonia to meet the agreement the Government had reached with the IMF without impairing the government's ability to deliver necessary policy reforms. The approach entailed that the Ministry of Finance prepare a budget with wage bill caps for individual ministries and agencies, accompanied by a hiring and wage freeze in 2001. The caps, it was suggested, should be developed so that the total government wage bill for all ministries/agencies represented the agreed aggregate limit, with the caps proposed for individual ministries/agencies reflecting the incorporation of special revenues within the central government budget and the exclusion of agencies and responsibilities slated for divestiture.

The caps were also intended to give recently merged ministries operational efficiency targets, and to take into account those ministries/agencies where the most significant increases in the wage bill occurred in prior years - unless there was felt to have been a compelling rationale for the increase. The government aimed to distribute any remaining cuts over all sectors, differentiating, to the degree possible, between higher and lower priority areas.

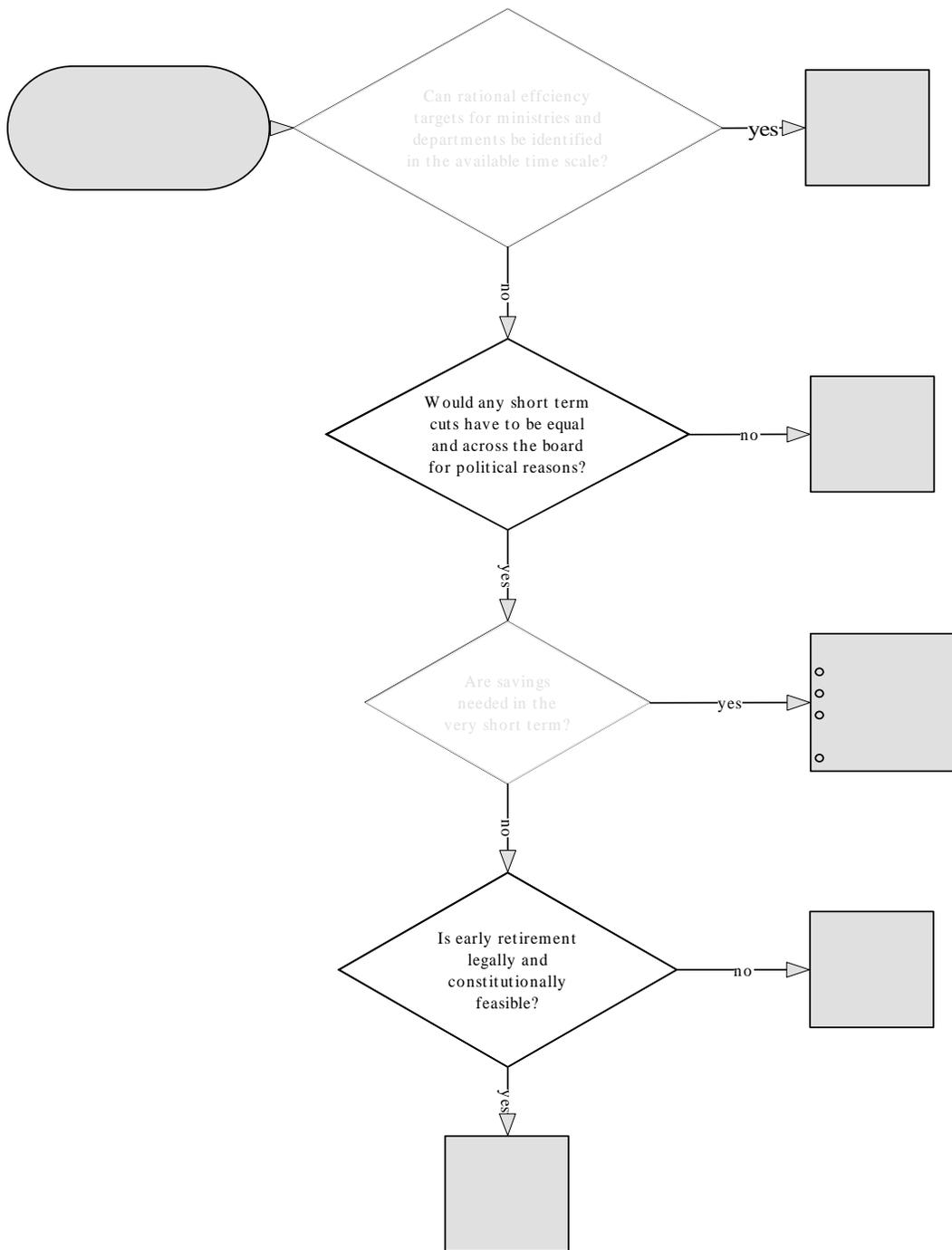
Employment reduction spreadsheet software was developed and provided to government in July 1999 to assist in prioritizing and setting realistic targets for net wage bill savings to be achieved and to assist individual Budget Users in sensibly targeting any employment reductions they needed to secure as part of this effort (Reid 1999). This was supplemented by a comprehensive World Bank review of institutional concerns (Public Expenditure and Institutional Review) and that was followed by more detailed advice to Government on the advantages and risks posed by various options for achieving wage bill cuts (Dorotinsky 2000).

Decision trees used

The implicit decision tree used is set out below. It begins with the requirement to identify the time scales on which efficiency savings are necessary, and the scale of savings required. It supports decisions concerning:

- Assigning efficiency targets to ministries
- Using targeted staff cuts
- Utilizing hiring freezes, wage freezes, base pay cuts and furloughs
- Considering across-the-board staff cuts
- Early retirement schemes.

**Decision tree 2 Identifying least damaging efficiency savings**



Sources: Authors, derived from (Dorotinsky 2000) and see Appendix 2: *Identifying 'pure' efficiency savings*

*Mainstream Ministry/agency-level functional reviews*

Key elements of the process

Typically, these reviews start with the identification of the key central Ministry/agency with responsibility for management of the program of functional reviews.. The targets of these reviews are ministries/agencies, **and** the significant programs for which they are responsible. There is no clear pattern in how candidates are identified : in some case encouragement and incentives are provided for volunteers to step forward; in others a rolling program covering all ministries/agencies is imposed and managed by the center.

Since these reviews target both organizations and programs, they are particularly technically complex, and there are two broad approaches for developing the expertise necessary to sustain them. In many cases, sometimes with donor support, external consultants are used. In other settings, multi-agency teams are brought together specifically for the purpose of the review, provided with necessary frameworks and orientation by the responsible central agency, and then dissolved.

The general steps are:

1. Obtain agreement to the methodology developed by the central government review program management Ministry/agency from the ministry/agency to be reviewed, and from all consultants/multi-agency teams that are to work on the reviews.
2. Facilitate extensive discussion on the review methodology.
3. Confirm that all parties understand governmental priorities as expressed in the program.
4. Disaggregate the functions that the agency undertakes in relation to this program:
  - 4.1 Policy functions;
  - 4.2 Co-ordination, supervision and performance monitoring functions;
  - 4.3 Service delivery functions;
  - 4.4 Support functions; and
  - 4.5 Regulatory functions.
5. Review those functions with a view to shedding services that can be stopped, reducing the volume or quality of services that cannot be stopped, and determining the resultant basic list of necessary functions:
  - 5.1 Those required for protecting public safety;
  - 5.2 Where there is a strong demand for the function to continue;
  - 5.3 Where the function supports other governmental priorities;
  - 5.4 Where national or international law or the constitution require the function
  - 5.5 Where the Government priorities cannot be achieved through regulation, taxation, transfers to subnational government, or subsidies.
6. Determine the operating environment that is most appropriate for those necessary functions:
  - 6.1 Inherently governmental;
  - 6.2 Devolved or decentralized;
  - 6.3 Contracted from the private or not-for-profit sectors;

- 6.4 Left to the private or not-for-profit sectors.
7. Structure the 'inherently governmental' environment in more detail by recommending that functions are allocated to:
  - 7.1 a core ministry; or
  - 7.2 statutory commission or independent regulator; or
  - 7.3 supervised body or executing agency; or
  - 7.4 state-owned enterprise or trading body.
8. Provide guidance on the internal structure of public sector organizations – indicating:
  - 8.1 whether functions should be located in a common department
  - 8.2 whether departments/divisions need restructuring; and
  - 8.3 whether managerial responsibilities are balanced and sustainable.
9. Open workshop to discuss findings.
10. Prepare final report with identification of priorities for implementation.
11. Wide dissemination of the review findings and recommendations.
12. Development of an implementation plan that defines:
  - 12.1 main tasks to be completed, including redundancies and redeployments
  - 12.2 likely resource requirements to implement review
  - 12.3 legislative requirements to support the review
  - 12.4 allocation of implementation tasks to designated managers
  - 12.5 project management arrangements
  - 12.6 change management program with key activities (workshops, press releases, etc.) identified.

#### Decision trees used

The methodology for mainstream Ministry/agency-level functional reviews is by far the most technically complex of the three reviews considered here. This is because the reviews are seeking to suggest improvements both in the activities that are undertaken and in the organizational arrangements that undertake them.

Four decision trees are used within these reviews. The first stage is generally to disaggregate the functions that ministries/agencies perform and review them with a view to shedding services that can be stopped, reducing the volume or quality of services that cannot be stopped, and determining the basic list of necessary functions that are to continue to be provided.

In breaking down the functions into discrete components, generally the typology employed is along the lines of that suggested by (Bannock Consulting 1999) for Latvia:

1. Policy functions;
2. Co-ordination, supervision and performance monitoring functions;
3. Service delivery functions;
4. Support functions; and
5. Regulatory functions.

(Bannock Consulting 1999) provides a useful summary of the functions that public sector bodies undertake and that should be distinguished prior to reviewing organizational form:

1. **Policy functions:** such as strategic planning, legal drafting, development of performance contracts, minimum standards, norms, policy analysis and evaluation, forecasting. These functions tend to be regarded as 'inherently governmental' and requiring specialist skills, and are usually provided by core ministries within central government.
2. **Co-ordination, supervision and performance monitoring functions:** such as coordinating relationships between different bodies, monitoring the performance of subsidiary bodies, facilitating and enabling subsidiary bodies to reach their performance targets. These functions also tend to be regarded as 'inherently governmental' and undertaken by core ministries.
3. **Service delivery functions:** such as the provision of products or services to internal (other public bodies) or external (farmers, foresters, fishermen) customers. Service delivery is often provided outside of central government through contracting arrangements or by subnational government. When undertaken by central government this is normally performed by supervised bodies or executing agencies.
4. **Support functions:** such as financial management, human resources management, information systems, infrastructure, staff training, efficiency review and management audit; and secretarial services. These are increasingly contracted out except when regarded as inherently governmental for security or other reasons.
5. **Regulatory functions:** such as licensing, certification, permissions, accreditation, inspection, compliance, and financial audit. These functions are also often regarded as 'inherently governmental' and provided by statutory commissions and other arms length bodies within central government. It is widely maintained that regulatory functions should be separated from those policy functions that determine the regulations, and service delivery functions that provide services to customers.

The axiom 'form follows function' was originally drawn from architecture (Louis 1956) but has now been firmly established as a managerial principle in the public sector. See for example (Audit Commission 1996; State Services Commission 1999). The key message is that it is important to reflect on the policy intentions and work out what government is trying to achieve before considering whether and how government should structure organizations to achieve those purposes.

There is, however, another principle implicit in the literature on this subject: "pragmatism determines practice". Whether or not the public sector should deliver services directly, there is little point in specifying an organizational option that cannot be sustained in practice.

Functions that are necessary are:

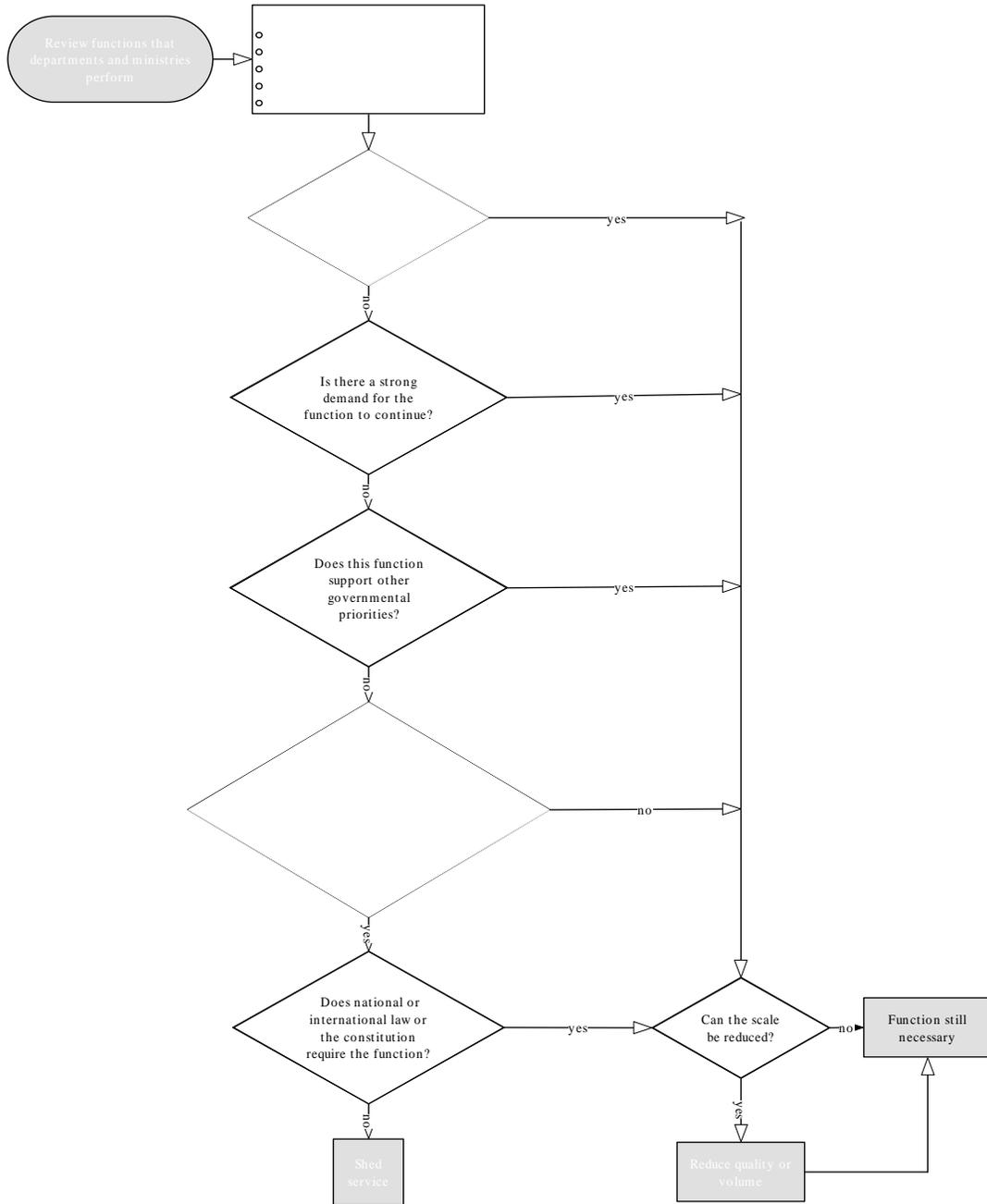
1. Those required for protecting public safety.
2. Where there is a strong demand for the function to continue.
3. Where the function supports other governmental priorities.
4. Where national or international law or the constitution require the function.
5. Where the Government priorities cannot be achieved through regulation, taxation, transfers to subnational government, or subsidies.

**Determining the Structure and Functions of Government : Program and Functional Reviews**

Some assessment is also required of the scale of the function. It might be necessary, but is it critical to undertake so much of it?

In the event that functions are not considered to be still necessary, service shedding is the form of divestiture that occurs when government reduces the level of service or stops providing a service altogether. A private firm or non-profit organization may assume the service at no or nominal cost if there is a potential market. See (Government of Manitoba 2000).

**Decision tree 3 Identifying necessary functions to be retained**



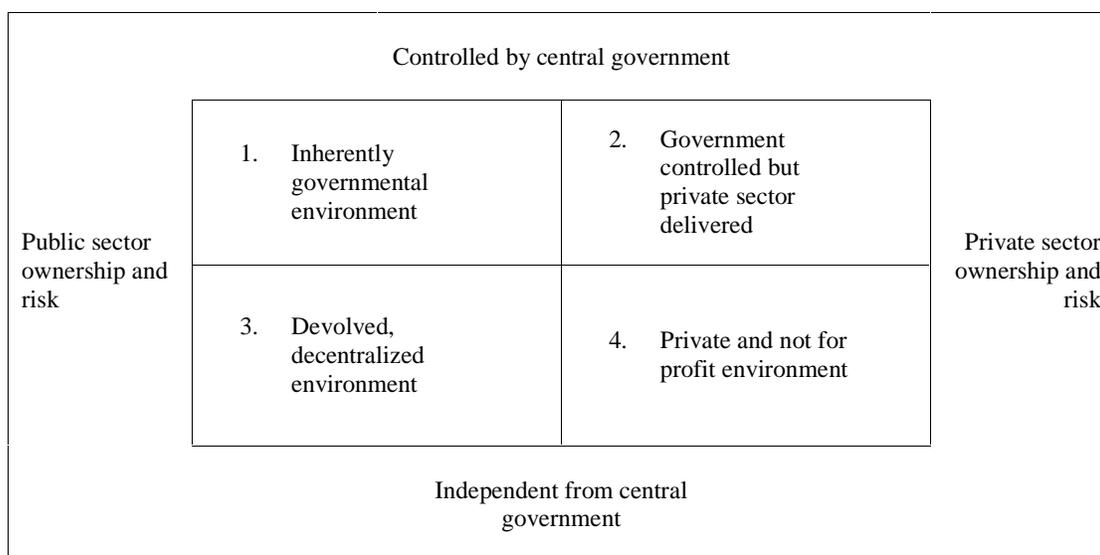
2. Devolved or decentralized; or
3. Contracted from the private or not-for-profit sectors; or
4. Left to the private or not-for-profit sectors.

Figure 4 sets out these four main environments in which governments might expect priority functions to be undertaken. The environments are determined by the degree to which they are controlled or independent from central government, and the degree to which the public sector owns the assets and explicitly assumes the risks of any business failure. The key assumptions are:

1. The choice of how functions are undertaken is not quite as simple as public or private, particularly in a federal setting.
2. Government priorities can be achieved through many mechanisms other than direct service delivery, including regulation, taxation, transfers to subnational government, and subsidies.

The first order question following the analysis of functions is which environment has, or could have, **the capability to undertake that function most effectively?**

**Figure 3 Operating environments**



There is a general assumption in favor of moving functions out of the top left quadrant, unless there are compelling reasons for leaving them there.

There is little that is inherently governmental because it can never be contracted out. Boston points out that practically any function can be delivered by the private sector and historically has been at one point or another. Mercenaries have been hired to fight wars and taxes have been collected by private organizations (Boston 1995). The assumptions that define which functions are 'inherently governmental' are of two sorts:

1. **Complexity and political sensitivity** - some functions are too intricate and sensitive to be contracted out.
2. **Pragmatism** – although a market *could* be created to undertake the function, this has not happened.

In defining functions that are 'inherently governmental', Boston highlights the risks of contracting out of policy advice to Ministers, pointing out that advisers on strictly commercial contracts are unlikely to be willing to go beyond the basic minimum terms of the contract, will not readily respond to changes in ministers, and will be difficult to monitor (Boston 1995). As Kettl notes: "It is one thing to hire outside concerns to supply goods and services. It is quite another to hire outside concerns to judge what the government ought to buy, how much it ought to pay, and how good the goods and services actually are. The more the government has contracted out its core functions, the more the government worsens its problem of building capacity" (Kettl 1993, p. 19). See also (Rhodes 1994).

More generally, the US Office of Management and Budget (OMB) suggest that an "inherently Governmental function" is one "that is so intimately related to the public interest as to mandate performance by Government employees." (Office of Management and Budget 1999, p. 2). These functions are defined as those that require either "the exercise of discretion in applying Government authority or the use of value judgment in making decisions for the Government."

OMB suggest that inherently Governmental functions normally fall into two categories:

1. Those that relate to the *act of governing* - the discretionary exercise of Government authority:
  - a. Criminal investigations, prosecutions and other judicial functions;
  - b. Management of Government programs requiring value judgments such as direction of the national defense, management and direction of the Armed Services;
  - c. Activities performed exclusively by military personnel who are subject to deployment in a combat, combat support or combat service support role;
  - d. Conduct of foreign relations;
  - e. Selection of program priorities;
  - f. Regulation of the use of space, oceans, navigable rivers and other natural resources;
  - g. Direction of intelligence and counter-intelligence operations;
  - h. Regulation of industry and commerce, including food and drugs.
2. Others that relate to *monetary transactions and entitlements*:
  - a. Tax collection and revenue disbursements;
  - b. Control of the Treasury accounts and money supply;
  - c. Administration of public trusts.

'Inherently governmental' functions are usually justified by reference to the complexity of the tasks, with fast-changing policies requiring more nuanced interpretations than can be achieved through contracts. In such circumstances, there is generally no effective market to purchase from as the services are not easily specified or priced. Arguably, central government also provides an environment in which staff know that their jobs are relatively secure and develop a loyalty to the government of the day. This is particularly important when budget funding might be unpredictable, as this tends to reduce public officials' overall performance (Manning, Mukherjee and Gokcekus 2000).

In summary, functions are reported to be 'inherently governmental' when policy is complex and prone to sudden reversals, when there is no realistic market (non-contestable, non-specifiable services), when service failure would be critical, when even-handed regulation is required, and when "forgiveness" (and the preparedness on the part of Ministry staff to take a long-term perspective) is required for unpredictable funding.

The section below provides further details of when and how service provision can be undertaken through devolved or decentralized organizations, or through contracting from the private or not-for-profit sectors, and when responsibility for providing the service or not can be left to the private or not-for-profit sectors.

### Devolving and decentralizing

#### *When?*

Strong arguments are made for the decentralization of key services, particularly education, health care, some infrastructure, provision of social safety nets, irrigation, water supply and sanitation, and natural resource management and environment. The arguments are nuanced but the claimed benefits include that decisions about public expenditure that are taken by a level of government closer, and more responsive, to a local constituency are more likely to reflect the demand for local services than similar decisions taken by a remote central government. A related benefit is that people are more willing to pay for services which they find to be responsive to their priorities, especially if they have been involved in the decision making process with regard to delivering the services (World Bank 2001b).

The principle of subsidiarity carries a strong normative value. See for example (European Parliament Directorate-General for Research 2001).

#### *Change processes*

(World Bank 2001b) provides details of the political, fiscal and administrative elements entailed in decentralization to subnational governments. Devolution or decentralization can be more than simple transfer of responsibility and funds. Partnerships can be established as **intergovernmental agreements** in which organizations at different levels of government contract with each other to deliver public programs or services. This collaborative arrangement is based on mutual interest and a clear understanding of objectives and terms. The partnership can be achieved through either shared services or devolution. **Shared services** involve a joint service agreement where two or more jurisdictions act together to plan, finance, and deliver a public service. **Devolution** involves an intergovernmental service accord where responsibilities are transferred between jurisdictions in return for payment for services delivered. See (Government of Manitoba 2000).

### Private and not for profit environments

#### *When?*

## **Determining the Structure and Functions of Government : Program and Functional Reviews**

There is some reasonable evidence that privatization offers significant benefits. 21 recent empirical studies are cited in (Shirley and Walsh 2000) and these generally find that most firms do better and all firms at least as well after privatization. None of the studies find that performance would be better had they not been privatized.

There are three key questions in considering moving functions to this environment:

1. Is there a market for these functions or services – or could one be created?
2. Can government tolerate the risk of closure?
3. Will any contingent liability be created or exacerbated?

The existence of a market for the services, or the possibility of creating a market, is generally regarded as more probable when policies are reasonably stable, when there is a prospect of raising revenue from fees and charges. The latter applies when the services are specifiable and contestable. See for example (Girishankar 1998).

The World Bank emphasizes privatization of state-owned enterprises following long experience with failed attempts at their reform. Few governments have been able to introduce – and keep in place – the large number of complex and demanding measures needed for effective public enterprise reforms. The Bank notes that whatever the theory, practice suggests that often inefficient but privileged public enterprises drained budgets, diverted resources from health and education, seriously damaged the health of the banking sector, and created obstacles for the development of the private sector (World Bank 2001c).

In principle, this environment is suitable only when government can tolerate the risk of closure or service failure. However, the literature on fiscal risk emphasizes that for central governments, privatization does not remove the potential contingent liability if explicit or implicit guarantees are offered. See (Polackova 1999a). Figure 5 sets out the principal risks identified by Polackova.

**Figure 4 Sources of fiscal risk**

	<b>Direct liabilities</b> <i>Predictable obligations that will arise in any event</i>	<b>Contingent liabilities</b> <i>Obligations triggered by a discrete but uncertain event</i>
<b>Explicit liabilities</b> <i>Specific government obligations defined by law or contract - the government is legally mandated to settle such an obligation when it becomes due</i>	<ul style="list-style-type: none"> <li>• Foreign and domestic sovereign debt</li> <li>• Budget expenditures—both in the current year and those legally binding over the long term (civil servant salaries and pensions)</li> </ul>	<ul style="list-style-type: none"> <li>• Guarantees for borrowing and obligations of fiscal subnational governments and public or private entities (development banks)</li> <li>• Umbrella guarantees for various loans (mortgage loans, student loans, agriculture loans, small business loans)</li> <li>• Guarantees for trade and exchange rate risks</li> <li>• Guarantees for private investments</li> <li>• State insurance schemes (deposit insurance, private pension funds, crop insurance, flood insurance, war-risk insurance)</li> </ul>
<b>Implicit liabilities</b> <i>A moral obligation or expected burden for the government, not in the legal sense, but based on public expectations and political pressures</i>	<ul style="list-style-type: none"> <li>• Future public pensions if not required by law</li> <li>• Social security schemes if not required by law</li> <li>• Future health care financing if not required by law</li> <li>• Future recurrent cost of public investments</li> </ul>	<ul style="list-style-type: none"> <li>• Defaults of subnational governments and public or private entities on non-guaranteed debt and other obligations</li> <li>• Liability clean-up in entities being privatized</li> <li>• Bank failures (support beyond state insurance)</li> <li>• Failures of non-guaranteed pension funds, or other social security funds</li> <li>• Default of central bank on its obligations (foreign exchange contracts, currency defense)</li> <li>• Collapses due to sudden capital outflows</li> <li>• Environmental recovery, disaster relief, military financing</li> </ul>

*Note:* These liabilities refer to fiscal authorities, not the central bank.

Source: (Polackova 1999b)

*Change processes*

**Privatization** is a process aimed at shifting functions, in whole or part, from government to the private sector when there is no continuing public policy reason to retain responsibility within government. **Divestiture** is a form of privatization involving the outright sale of government-owned assets or enterprises. After divestiture, government generally has no role in the financial support, management, regulation, or oversight of the divested activity. Consumers, through their buying

choices, determine the ultimate viability of the company and the resulting profits allocated to shareholders. In selected cases, government may sell its assets or controlling interest in a service to a private company but protect the public interest through regulation. This is called **regulated** privatization. See (Government of Manitoba 2000).

There are two key areas of market design:

1. Ensuring appropriate regulation; and
2. Enforcing sound corporate governance.

In ensuring appropriate regulation the challenge is that of dealing with potential monopoly practices, and determining when privatization without regulation can be achieved (when conditions for contestable markets exist); when regulated privatization is necessary; and when concession or franchising (allowing one private firm to operate as a regulated monopoly for a limited amount of time) is appropriate.

Corporate governance refers to the maintenance of "balance between economic and social goals and between individual and communal goals" (Dyck 2000; World Bank 2001a).

**Employee Take Over** can be a useful device for privatization. This is an agreement between government and an employee group to have services formerly performed within government provided by the employees as private owners/operators. Prior to the employees resigning from public service to form an ETO company, a contract, lease, or license is negotiated with the government. The take-over group may be required to prepare a competitive proposal alongside private vendors to deliver services. Some organizations offer employees equity through profit sharing to recognize performance, while others sell or lease the operation outright to employees. Considerations in take-over bids include: comparison of cost-benefits with other options; status of the business as a new operation or going concern; valuation and ownership of assets; protection of the public interest through a government equity position; modification of conflict of interest, post-employment codes, and early departure/retirement incentives; union successor rights; and government assistance to employees in developing proposals. An ETO encourages employees to show entrepreneurship and can result in transfer of jobs to the private sector rather than simply job losses.

#### Government controlled but private sector delivered

*When?*

If government must continue to subsidize the function because citizens or businesses could not realistically pay full costs, or if the function is significant and government could not tolerate the risk that the market might cease to undertake the function in the future, then contracting out to the private or not-for-profit sectors is assumed to be preferable.

(Siegel 1999) provides an overview of recent research findings in the successes and limitations of external contracting. The general conclusions are that the most promising targets are those services with clear objectives for the provision of tangible

services that can be measured and monitored. Contracting has apparently been less effective in human services and property assessment. In process terms, contracting is generally less successful following sole-source contracting.

Others present a more cautious view. They argue that contracting is more costly than initially apparent and that there are particular problems in contract specification (especially for complex services), and that the cost and difficulty of monitoring contract performance often cause governments to bring previously privatized work back in house. (Ballard and Warner 2000) argue that restructuring through improved labor-management cooperation can provide better quality service with fewer risks and greater social rewards. See also (Ballard and Warner 1999).

### *Change processes*

**Service provision under contract** from private providers can be through **contracting out** arrangements to procure goods or services used in delivering government programs from external organizations, usually the private sector. Government transfers the supply or operation of a function to a contractor for a specified period of time without relinquishing program responsibility and accountability. It remains the financier, has management and policy control over the type and quality of goods or services to be provided, and can replace contractors that do not perform up to the standards and service requirements of the contract negotiated. **Franchising** is a form of contracting whereby government confers the right or privilege to a private concern to conduct a business or sell a product or service in a specific geographic area according to prescribed terms and conditions. Franchises can be either exclusive (i.e., one producer) or inclusive (i.e., many producers), depending on the government's interest in leveraging the marketplace. **Licensing** is another variation through which government grants a license to a private concern to sell a product or service that would not otherwise be allowed outside the public domain. Under either scenario, consumers choose and pay directly for services, contractors pay government a franchise or license fee, and compliance with public purposes and regulations is enforced. Contracting works best for services commonly performed by private companies where outputs can be measured, complexity and contract monitoring are minimal, services can be unbundled, and user fees are charged.

Contracts can be with a **private, not-for-profit agency** - a formal agency volunteer program or a private non-profit service organization in which volunteers provide all or part of a service, either independently or under government direction. Government delegates responsibility to these organizations and provides grants or transfer payments. Other sources of funding are also accessed to deliver the service or perform a self-regulatory function.

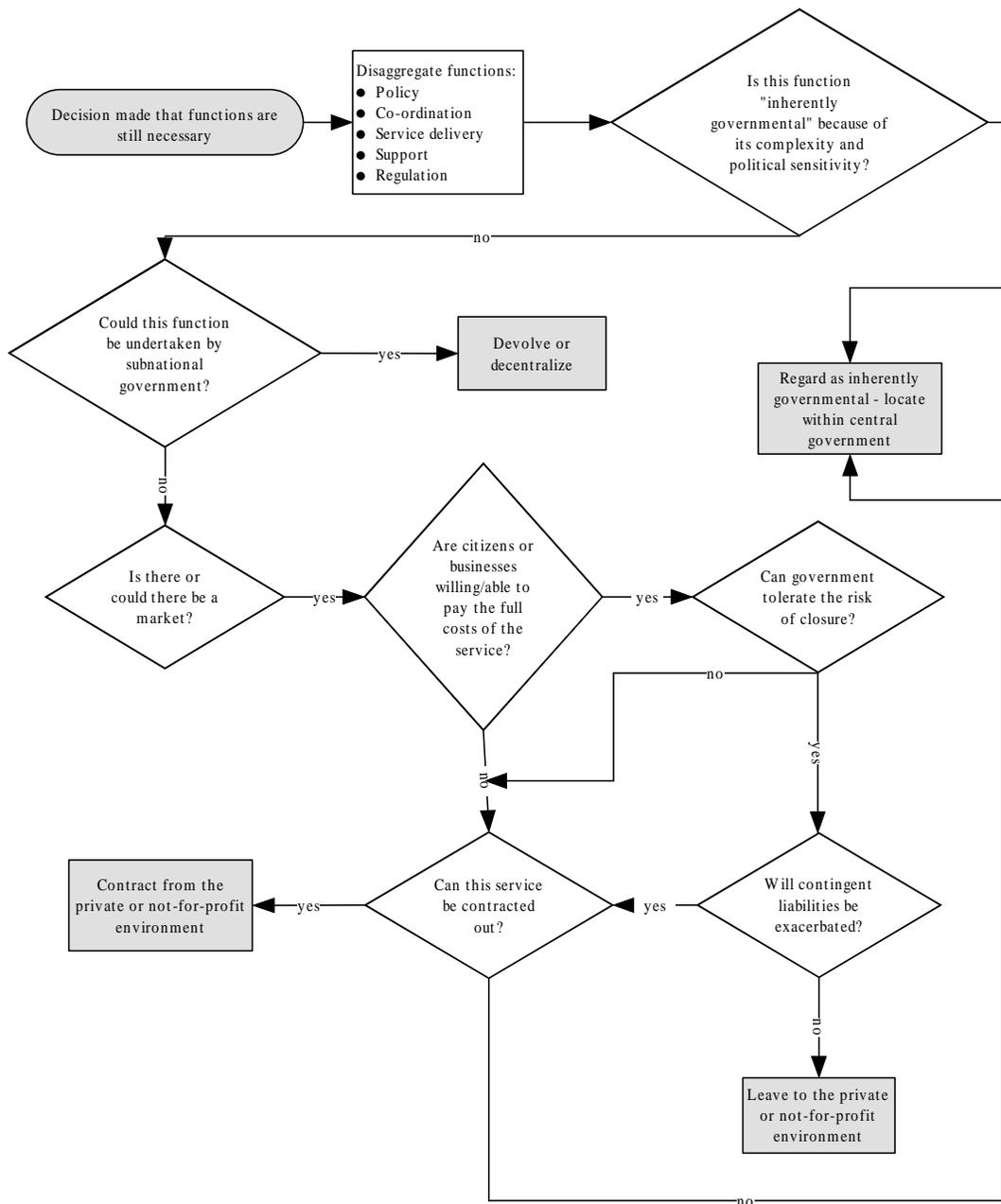
**Public/Private Partnerships** are cooperative or joint ventures between two or more parties in the public and private sectors, built on the strength and expertise of each partner, where public needs are agreed upon upfront and are met through the appropriate allocation of resources, risks, and rewards. The contractual arrangement negotiated involves the private sector in the development, financing, ownership, and operation of a public facility, infrastructure, or service. Financial and human resources are pooled and responsibilities divided so that the partners' efforts complement each other. The partners typically share any income or losses in direct

proportion to their investment. Such ventures differ from conventional service contracting in that the private partner usually makes substantial cash, at-risk, equity investment and government gains access to new revenue or service delivery capacity without having to pay the partner. Leasing and buy-out options can be used to facilitate public and private participation. Ultimately, an elected official or body is accountable to the public for decisions and results, while responsibility for achieving planned objectives is shared by the government and partners. (Thomas 1998) provides further details.

**Box 2 Government Owned/Contractor Operated**

**Government Owned/Contractor Operated (GOCO)** arrangements are a special case of such public/private partnerships. These are organizational and commercial arrangements where a government-owned facility is operated by a third party, usually a for-profit contractor. It is used when a government purpose-built facility managed by the private sector remains consistent with the public interest; when a government-owned facility has surplus capacity that a commercial operator can market to the private sector; when technology needs to be transferred to the private sector using private expertise; and as a transitional vehicle for a prospective operator who initially cannot afford to purchase the facility. Government's expectation is that access to private management expertise will increase efficiency, business volumes, and leasing or royalty revenues while lowering unit costs. The contractual relationship negotiated provides for adequate control and intervention mechanisms to protect government interests; structures exchanges of information, requests for service, performance criteria, and evaluations to reflect full costs, profit, and accountability; and transfers and manages assets consistent with government's long-term interests.

**Decision tree 4 Selecting the appropriate operating environment**



Sources: Authors, derived from (Bannock Consulting 1999; Civil Service Reform Programme Steering Committee 1996a, b, c, d, e, f, g, h, i, j; Defense Logistics Agency 2001, exhibit 3-6: flowchart for assessing which DAPS functions are appropriate for transfer; István 2000; Wilkins 2001). See Appendix 2: *Operating environments*.

***Dealing with inherently governmental functions***

Having allocated functions to operating environments, the third decision tree offers guidance on **how to structure the 'inherently governmental' environment**. The choices are whether 'inherently governmental' functions should be located in:

- a core ministry; or

- statutory commission or independent regulator; or
- supervised body or executing agency; or
- state-owned enterprise or trading body.

**Core ministries**<sup>10</sup> are best at managing sensitive policy areas when there is no realistic market and there is need for a margin of safety against service failure or a requirement to "forgive" unpredictable funding. Generally, ministries provide policy advice, analysis and evaluation. There is an implicit assumption that ministries are best suited to:

- Manage sensitive and volatile policy areas prone to sudden political reversals;
- Deliver services in which there is no realistic market (non-contestable) and which are hard to specify;
- Providing a margin of safety against service failure for very politically sensitive services – this includes the ability of core ministries to "forgive" unpredictable funding for operational activities, as secure civil service employment makes staff more prepared to judge government behavior over the longer term.

Ministries may exhibit bureaucratic tendencies, including command and control, hierarchy, uniformity, and conformance to rules and process : however the operational efficiency losses are considered a price worth paying for the margin of safety that they provide in delivering sensitive policy areas. Some challenges and opportunities facing Ministries can be resolved within the current structure by modifying operations to perform in a more business-like way.

**Supervised bodies or executing agencies**<sup>11</sup> are suited for policy areas that are prone to rapid adjustments and where there is no realistic market. These bodies and agencies deliver services where the public sector has a comparative advantage, but need to be placed in a clear accountability framework to a particular Ministry. They tend to be the vehicle of choice for:

- Policy areas prone to adjustment but not dramatic reversals – for example foreign affairs responsibilities are rarely located in an agency, while social security often is
- Delivering services in which there is no market (non-contestable) but where the output required is relatively specifiable.

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<sup>10</sup> Ministries are in a legal or constitutional sense indistinguishable from the state. They often have no specific legislative basis and their assets are the general property of the state. Their functions and objectives are multi-purpose, complex tasks, traditionally defined by legislation (Continental European traditions) or determined incrementally by Cabinet (UK and other Anglophone traditions). Their source of funding is almost entirely the state budget and they usually have nil or very minor revenue earnings. As they have no corporate or legal identity separate from the state, they have generally no legal competence to enter into corporate contractual relationships with suppliers.

<sup>11</sup> Executing agencies reporting to Ministries (or reporting to Ministers but under the day-to-day supervision of a Ministry) are often indistinguishable from the state in the legal or constitutional sense. However, the relevant Minister generally defines their objectives (perhaps in a framework agreement) and their source of funding can include some revenue earnings. Executing agencies also rarely have legal competence to enter into contractual relationships with suppliers.

**Box 3 Canadian Special Operating Agencies**

Canadian Special Operating Agencies are a particular example of supervised bodies or executing agencies. SOAs exist along an organizational continuum between a government department and a state-owned corporation. Candidates can be direct public services, internal services to government, science and technology services, or regulatory and enforcement programs. Government delegates service delivery to a designated agency operating at arm's length from mainstream government. The agency remains accountable for results to governing bodies and may have an advisory board comprised of key stakeholders to provide guidance on strategic management. SOAs are distinguished from conventional departmental structures by: a clear mandate confirmed with stakeholders and made public in an operating charter; the requirement to examine becoming an optional rather than mandatory service provider; an accrual basis of accounting, usually applied outside the government's consolidated fund; access to financing and investing supported by a multi-year business plan; full costing and pricing of services, with a view toward financial self-sufficiency; and flexible staffing and continuity in labor relations.

**Statutory commissions and independent regulators** are best suited for functions that fall within a stable policy environment and for regulatory services. Agencies are "statutory commissions" when that they have a well-defined separate legislative existence. Their objectives are often enshrined in a charter, and their functions are defined by legislation in addition to any powers of direction held by the Minister. They may also be non-asset owning (legally distinct but unable to own assets) or asset owning. They can be budget dependent (subvented) or collect significant revenue earnings. They can also have legal competence to enter into contractual relationships. Such bodies tend to be established for regulatory purposes, although in some presidential systems they can also be service providers.

Statutory commissions provide arms length arrangements when checks and balances are required.

**Trading bodies** can provide functions when the policy environment is stable and there is scope for raising revenue from fees and charges. Trading bodies also have a separate legislative existence. If established under commercial law, then articles of association define their charter and functions. They can be budget dependent, subsidized, or enjoy significant revenue earnings. Trading bodies generally have full legal competence to enter into contractual relationships – they can assume corporate liability and can be sued. Trading bodies provide services that can be operated following private sector models.

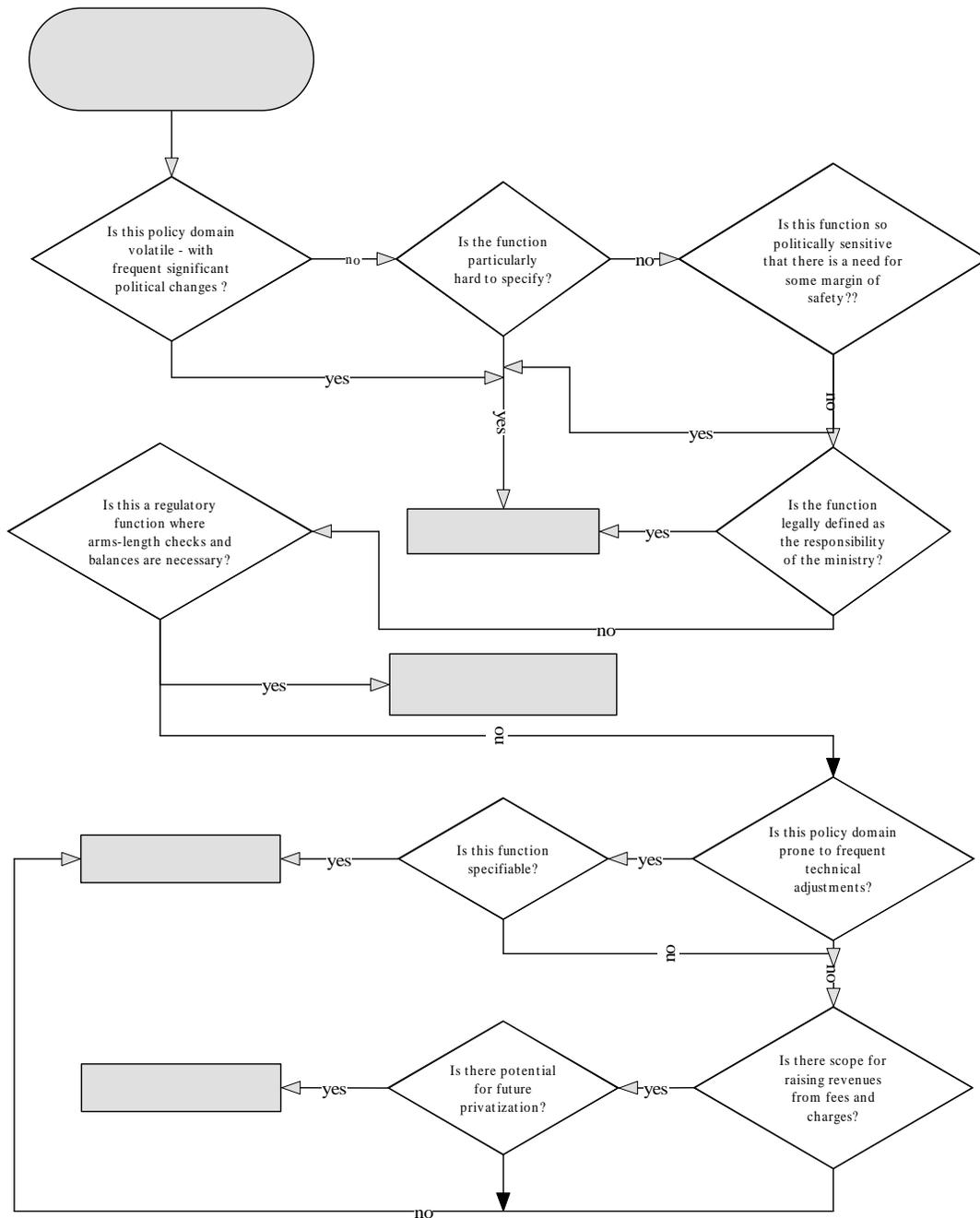
Utilities for producing, transmitting, delivering, and furnishing water, electricity, gas, or steam heat; conveying persons or goods; and collecting and disposing of sewage, solid waste, and refuse are the most common examples. A utility is often a monopoly but is expected to apply business-like practices and consider market forces, incentives, and mechanisms to improve service delivery, reduce costs, and protect the public interest. User fees are commonly used to promote fairness, equity, and good management by shifting some or all program costs away from taxpayers to those who derive a direct benefit. While powers can be extended to manage assets, maintain separate accounts, collect charges, and enter into contracts and partnerships, the authority to fix rates and expand services continues to reside with governing bodies, including other orders of government. (Wright 1998) provides details.

There are sufficient cautionary lessons from experience in the management of state-owned enterprises to argue that they should only be used as transitional arrangements for candidates for privatization. Experience suggests that although a nationalized sector has, in principle, the advantage of easier coordination and the ability to fine-tune business practices to achieve social goals, in practice information asymmetries between the government and the firm and the difficulty in enforcing contracts leads to significant inefficiencies (Schmidt 1996; Shapiro and Willig 1990). In particular, public enterprises tend to operate with the security that the government will not allow them to go bankrupt and tend to offer them relatively soft budget constraints. Also, they tend to overinvest, because they can exert political power (Galal, Jones, Tandon and Vogelsang 1994).

**Box 4 Crown Corporations**

**Canadian Crown Corporations** are a special case of trading bodies. These are separate legal entities created by federal or provincial statute, generally with the intent of conducting revenue-producing, commercial activities for the public good. Crown corporation status represents the greatest degree of autonomy possible within the public sector. A Crown Corporation is normally a sizable agency that sets its own administrative policy, is financially self-sufficient, and has separate employer status. A board of directors, appointed in whole or part by government, is responsible for overall management and decision-making for the corporation. A Minister responsible answers in public and interprets the nature of the arm's-length relationship, consistent with legislation and the public interest.

**Decision tree 5 Locating inherently governmental functions**



Sources: Authors, derived from (Bannock Consulting 1999; Civil Service Reform Programme Steering Committee 1996a, b, c, d, e, f, g, h, i, j; István 2000; Wilkins 2001). See Appendix 2: *Choosing organizational form*.

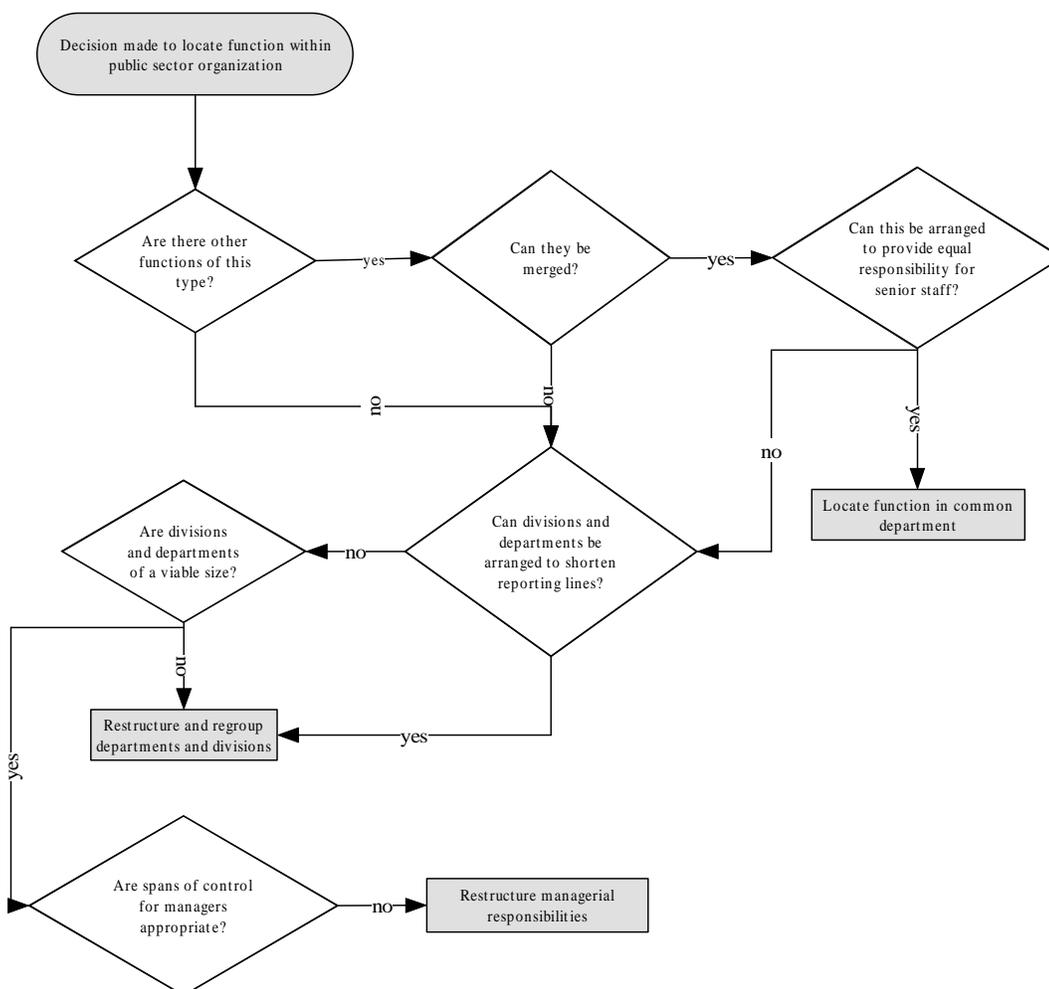
Following the proposal to transfer functions, the final stage is to **review the internal structure** of the ministry, statutory commission, supervised body, trading body and to determine whether there is a need for restructuring. The final decision tree provides guidance on the internal structure of public sector organizations. It assists in determining whether services should be located in a common department, whether

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departments or divisions need restructuring, and whether managerial responsibilities are balanced and sustainable.

1. Functions of the same type should be grouped together whenever possible to produce economies of scale and maximize synergies and common types of skills;
2. Support functions that enable the core functions of the organization to be performed should be separated from all other functions;
3. There should be equal responsibility for senior staff, either in terms of volume of workload or national importance of the function;
4. There should be clear and short reporting lines;
5. There should be viable sizes of divisions and departments (five or more experts to a division), three to five divisions in a department;
6. Different organizational units should perform different types of functions (policy, regulation etc);
7. Structures should take into account local history, culture and circumstances;
8. There should be optimum spans of command for managers;
9. There should be equitable workloads;
10. Structures should be compatible with international and local Law, and where there are conflicts these should be highlighted and options explored for amending legislation.

**Decision tree 6 Structuring public sector organizations**



Sources: Authors, derived from (Bannock Consulting 1999; Civil Service Reform Programme Steering Committee 1996a, b, c, d, e, f, g, h, i, j; István 2000; Wilkins 2001). See Appendix 2: *Managerial arrangements within public sector organizations.*

Rolling out mainstream Ministry/agency-level functional reviews

While the more upstream forms of review tend to stand alone, mainstream Ministry/agency-level functional reviews come in batches. So, for example, 'pure' policy or program reviews such as the Brazil – inventory of government programs and the Government of Canada – 1994 program review, were stand-alone. There was only one of them at one time. An upstream program and efficiency review such as the New Zealand – reviews of the State Sector, were also one of a kind.

By contrast, mainstream Ministry/agency-level functional reviews such as the Government of Canada – ongoing Alternative Service Delivery reviews, and the Fundamental Expenditure Reviews and the Better Quality Services and Best Value Reviews in the UK, are replicated many times over in different agencies and across different programs. The choice is whether to impose uniformity or to set a broad framework allowing different emphases to emerge in different reviews.

The UK and Canada in their versions of these types of review have moved from a centrally driven model, in which selected programs, agencies and departments were identified as the targets for review, towards a more open model in which central guidelines are set out, but the details of review implementation are left with the agencies themselves. Arguably, this has been possible because of the discipline that was established by the initial, centrally driven program.

The consequence of for the UK Better Quality Services Reviews is that all services and activities, including policy and headquarters functions, are reviewed over a five-year period. Each Department is committed to reviewing 60% of its activities in the next three years and 100% in the next five years. This is enforced by a plan agreed by the relevant Minister that shows how and when coverage will be completed. The plan must cover all subsidiary bodies such as Executive Agencies and other bodies with an annual budget of over £15 million. Monitoring results are passed to a special Cabinet Committee and assessed against each Department's review timetable.

Further discipline is maintained by the Departmental Public Service Agreements, which require each department to prepare its aim and objectives, with specific performance targets (H.M.Treasury 2000). Each Public Service Agreement includes targets for improving the efficiency or value for money of a key element of a department's work, and a statement of who is responsible for the delivery of these targets. Where targets are shared between two different departments, then this is identified and accountability arrangements are clearly specified.

## **IV A Methodology for Functional Reviews in the Russian Federation**

### *Objectives*

This section sets out a methodology for conducting functional reviews in Russia which is both appropriate to present needs and circumstances in Russia as part of the approach to development and implementation of a program for administrative reform over the short to medium-term; and which also takes appropriate account of lessons and experiences of conducting such approaches over recent years in a wide range of countries. This approach is based on a model which we have described as **mainstream Ministry/agency-level functional reviews**.

### *Recommended approach : Mainstream Ministry/agency-level functional reviews*

Mainstream Ministry/agency-level functional reviews are designed to achieve outcomes such as the reshaping of some Government programs, the dropping of some activities, and the restructuring of some entire Government Ministries and agencies. The focus of the reviews is on identifying core governmental functions, eliminating duplication, and consolidating and/or merging similar services from different Ministries or departments.

Mainstream Ministry/agency-level functional reviews are usually developed and implemented to meet one or more of the following objectives:

- (i) identifying **expenditure reductions**;
- (ii) **reducing the size and scope of Government** through rationalizing Ministry structures; and through identifying functions and services which may be commercialized, spun off, decentralized to lower tiers of Government, or simply eliminated;
- (iii) **securing increased efficiency** in Ministries' performance;
- (iv) **securing increased effectiveness** in Ministries' performance through strengthening the focus of individual civil servants on the achievement of key Government goals and objectives (as set out in the Government's work program); and strengthening the responsibility and accountability framework in which civil servants operate.

Implementation of a program of such functional reviews should therefore be expected to lead to increased focus on the achievement of priority Government goals and objectives; while allowing significant expenditure reductions in many areas to be made (it should be noted though that the outcome of such reviews in certain areas

could be the identification of the need for expenditure increases); but without sacrificing efficiency and effectiveness in service delivery.

Such a program of reviews at Federal level in Russia would be designed to be undertaken at the level of an individual Ministry, including all its Services, Agencies and other subordinated organizational units and budget entities. Such reviews would be undertaken in the context of explicit top-down criteria established either by the Commission on Administrative Reform or by central government Ministries acting on behalf of the Commission such as the Apparat of the Government, the Ministry of Finance and the Ministry of Economic Development and Trade. As outlined in the discussion of this type of review above, these reviews would be designed to allow for significant restructuring of present Ministerial structures, with some functions/entities identified for being spun off or commercialized, some for decentralization to other tiers of Government, some for transfer to the not-for-profit sector, and some potentially simply for closure or elimination.

***Links with performance based budgeting and public expenditure reviews***

Such a program of functional reviews could also be used to build on the program for budget reform (including budget process reforms as well as efforts to secure expenditure reductions and to increase efficiency and effectiveness in Government expenditures) and in particular on the move to performance-based budgeting and the production by all Ministries of performance budget reports (the next round of performance budget reports would be produced over the next few months and would form the basis for the 2006 budget formulation exercise.).

There appear to be at least two options for the sequencing of the performance budget reports and functional reviews. The first option would be for a functional review to be undertaken on a Ministry and all its subordinate structures in time for the results of the functional review to be available when the Ministry came to complete its next performance budget report. Under the second option, the functional review would be undertaken in response to the Ministry's draft performance budget report and would provide a means by which the Commission on Administrative Reform could challenge and validate and test the Ministry's proposals before moving to the formal budget allocation stage of the performance budgeting exercise for the year in question. In either case, the results of the functional review would then firstly be used to provide assurance to central agencies of Government such as the Apparat of Government, the Ministry of Finance, and the Ministry of Economic Development and Trade that the determined budget ceiling for the Ministry in question could be achieved without jeopardizing achievement of key Government priorities and objectives in the areas falling in the remit of that Ministry. Secondly, the exercise could be used by the management of the Ministry in question to enable them to identify the most appropriate arrangements for prioritization and provision of functions and services in the context of both the Government's overall objectives and goals, but also in the context of the determined budget ceiling.

***Key elements of the recommended functional review approach : methodology***

The general steps to designing and launching such a functional review could be as follows:

1. **Establish a task force** for the functional review exercise and agree timing, criteria and precise methodology. **Obtain agreement to the methodology** from the ministry, from the responsible central agency (or agencies), and from all consultants/multi-agency teams that are to work on the reviews.
2. Facilitate **extensive discussion** within the Ministry on the review methodology so as to seek to minimize internal opposition to the review process and to eventual implementation of the recommendations of the review.
3. **What are the priorities?** Confirm that all parties understand governmental priorities as expressed in the Government's program and how these priorities are reflected in disaggregated form at the level of the Ministry itself.
4. **How can the Ministry's functions best be separated out?** The need is to disaggregate the functions that the Ministry undertakes using a classification such as the following:
  - 4.1 Policy functions;
  - 4.2 Co-ordination, supervision and performance monitoring functions;
  - 4.3 Service delivery functions;
  - 4.4 Support functions; and
  - 4.5 Regulatory functions.
5. **Which functions should still be provided?** The need is to review functions with a view to shedding services that can be stopped, reducing the volume or quality of services that cannot be stopped, and determining the resultant basic list of necessary functions:
  - 5.1 Those required for protecting public safety;
  - 5.2 Where there is a strong demand for the function to continue;
  - 5.3 Where the function supports other governmental priorities;
  - 5.4 Where national or international law or the constitution require the function
  - 5.5 Where the Government priorities cannot be achieved through regulation, taxation, transfers to subnational government, or subsidies.
6. **How can remaining functions best be provided?** The need is to determine the operating environment that is most appropriate for those necessary functions:
  - 6.1 Inherently governmental;
  - 6.2 Devolved or decentralized;
  - 6.3 Contracted from the private or not-for-profit sectors;
  - 6.4 Left to the private or not-for-profit sectors.
7. **How can remaining functions most appropriately be allocated to different types of Government bodies?** The need is to structure the 'inherently governmental' environment in more detail by recommending that functions are allocated to:
  - 7.1 a core ministry; or
  - 7.2 statutory commission or independent regulator; or
  - 7.3 supervised body or executing agency; or
  - 7.4 state-owned enterprise or trading body.
8. Provide guidance on the **internal structure of public sector organizations** – indicating:
  - 8.1 whether functions should be located in a common department
  - 8.2 whether departments/divisions need restructuring; and

- 8.3 whether managerial responsibilities are balanced and sustainable.
9. **Open workshop** to discuss findings
10. Prepare **final report with identification of priorities for implementation**
11. **Wide dissemination** of the review findings and recommendations
12. **Development of an implementation plan** that defines:
  - 12.1 main tasks to be completed, including redundancies and redeployments;
  - 12.2 likely resource requirements to implement review;
  - 12.3 legislative requirements to support the review;
  - 12.4 allocation of implementation tasks to designated managers;
  - 12.5 project management arrangements; and
  - 12.6 change management program with key activities (workshops, press releases, etc.) identified.

***Key elements of the recommended functional review approach : process***

The suggested first immediate action when setting up an individual functional review exercise for a particular Ministry and its associated structures and budget entities is to establish a clear terms of reference for the exercise, with clear criteria established which are acceptable both to key central Government agencies such as (in the case of the Russian Federation) the Commission on Administrative Reform or agencies acting on its behalf such as the Apparat of the Government, the Ministry of Finance, and the Ministry of Economic Development and Trade;, as well as being broadly acceptable to management of the Ministry itself. This process would need to be accompanied by a top-down confirmation of the key priority objectives and goals for the Ministry overall as reflected in the Government's work program.

The next step is to establish a Task Force for the particular exercise. This would comprise internal Ministry staff, possibly also staff from the central agencies of Ministry of Finance and Ministry of Economic Development and Trade and/or the Apparat of the Government, and usually also external consultants (both international and local). Appropriate tender and contracting arrangements for the consultants would also need to be set up and completed. The accountability framework for this Task Force would also need to be established, together with formal reporting requirements and a timetable for completion of the work and preparation and submission and consideration and approval of the review's findings (normally set out in a draft final, then final, report); together with arrangements for publication and dissemination of the final review report. Such an accountability framework could comprise a Steering Committee, which again could include representatives from the Ministry itself (management and staff), together with representatives from the interested central Government agencies.

As concerns timing for such an exercise, experience from other countries seems to indicate that a period of **six months** from exercise launch through to submission of final report is likely to be required.

The first stage of the review work itself is generally to **disaggregate the functions** that departments and ministries perform and review them with a view to shedding services that can be stopped, reducing the volume or quality of services that cannot be stopped, and determining the basic list of necessary functions. Although clearly this

task must be open and participatory, experience suggests that defining agencies' current core tasks is at root the responsibility of the current management. excessive reflection at this point can bog the review down in long discussions about the nature of the existing tasks.

***Completing the review : The final workshop and dissemination of the implementation plan***

Following completion of the review work, there would normally be a **workshop to finalize and approve the implementation plan**. This implementation plan would need to show and reflect the required linkages with the Government's budget cycle. It would show the costs associated with implementing the review's recommendations (including further consulting support, change management, training, IT), and the expected savings (if any). The plan would identify which changes would need to be made to legislation or to existing normative acts so as to support the implementation of the review's recommendations. The plan would also normally provide for appropriate staff consultation on the implementation issues and timetable, and would seek to include mechanisms for aligning staff support behind implementation of the review's recommendations. Finally, the implementation plan should identify the monitoring measures and approaches and methodology to be used to ensure that the outcomes expected from implementation can be assessed, as well as the costs and savings associated with implementation.

***Short-term next step : Implementation of pilot functional reviews***

The objectives set out above could be achieved through making provision in the short-term action plan being developed in the context of the work of the Commission on Administrative Reform for the implementation of a number of pilot functional reviews initially over the period December 2004 to March 2005. Given this, the Government, supported by the World Bank, would need by December 2004 to mobilize and secure the required internal budget resources and any additional external donor financing required to cover the costs of undertaking such pilot functional reviews. Provision for the costs of any subsequent ongoing rolling program would need to be discussed in the context of decisions on financing from 2006 onwards for the planned program of administrative reform.

***Conclusion***

While the approach set out above represents the ideal, it is probably more important quickly to build up experience of conducting such functional reviews and to seek to move quickly to implementation of their recommendations than it is to follow this ideal sequencing. Thus if a particular Ministry wished on its own initiative to have such a functional review undertaken on its structure then it would probably be appropriate to move ahead with such an exercise.

Secondly, it could also be worth seeking to stimulate acceptance of this **functional review approach at the level of individual regional administrations and cities**, and to seek to encourage the completion of a number of pilot reviews at these levels. This is of course particularly important given that most of the service delivery responsibilities in key national expenditure areas such as education, health and social,

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are undertaken at the lower tiers of Government. It would be particularly valuable to seek to integrate criteria and findings from for example a functional review on the Ministry of Education at Federal level, together with functional reviews of education service delivery in a number of regions and cities.

Finally, experience has shown very clearly that while expectations around functional reviews are nearly always high, results are often disappointing. It should be expected and accepted from the outset therefore that some exercises will lead to more satisfactory results than others. The process of undertaking functional reviews should be seen as an iterative one, and one that will deliver increasing benefits over time in terms of efficiency and effectiveness gains and in terms of sharpening the focus of Ministries and other Governmental structures on the achievement of key Governmental goals and priorities. Such exercises can also play an important role in promoting the change in values and behaviors on the part of individual civil servants that will be required for the Government's overall objectives in the area of modernizing the public administration through administrative reform, budget reform and civil service reform to be met.

## Glossary

<b>Alternative Service Delivery</b>	Alternative Service Delivery (ASD) refers to the organizational and structural choices in improving the delivery of programs and services. It is originally a Canadian term used to encourage managers to think imaginatively concerning the best organizational option.
<b>Autonomous Service Units (ASU).</b>	A service operation within government granted more direct responsibility for results and increased management flexibility needed to reach new levels of performance in Quebec. It is an example of a supervised body or executing agency.
<b>Central agencies</b>	Those organizations in the executive branch that co-ordinate the activities of, and provide guidance to the operating ministries and agencies. Practices vary widely from country to country, but central agencies are generally regarded as including: <ul style="list-style-type: none"> <li>• the Ministry of Finance;</li> <li>• the Cabinet Office, or the ministry assisting the Prime Minister or the Council of Ministers in the development and co-ordination of policy;</li> <li>• the ministry or agency responsible for developing and coordinating policies in relation to human resource management within the public sector; and</li> <li>• the Ministry of Foreign Affairs, in certain areas of work such as policy on European integration.</li> </ul>
<b>Contracting Out</b>	Government transfers supply or operation of a function to a contractor for a specified period of time without relinquishing program responsibility and accountability.
<b>Crown Corporation</b>	A separate legal entity created by federal or provincial statute in Canada, generally with the intent of conducting revenue producing, commercial activities for the public good.
<b>Decision trees</b>	A method for conveying succinctly the complex assumptions and criteria that drive reviews – the source of their critiques of existing policies and organizational structures.
<b>Devolution</b>	A form of public partnership involving an intergovernmental service accord where responsibilities are transferred between levels of government (for example federal and provincial) in return for payment for services delivered.
<b>Divestiture</b>	A form of privatization involving the outright sale of government-owned assets or enterprises. After divestiture, government generally has no role in the financial support, management, regulation, or oversight of the divested activity. Government may sell its assets or controlling interest in a service to a private company but protect the public interest through regulation.
<b>Downstream organizational review and business process re-engineering</b>	Reviews that envisage dropping or changing specific activities and services, or the detailed restructuring of a few specific agencies.
<b>Efficiency and effectiveness reviews</b>	A discrete approach for developing recommendations for change, outside of the usual budget and planning cycle.
<b>Employee Take Over (ETO)</b>	An agreement between government and an employee group to have services formerly performed within government provided by the employees as private owners/operators.
<b>Executive Agency</b>	A service operation within government granted more direct responsibility for results and increased management flexibility needed to reach new levels of performance in the UK. It is an example of a supervised body or executing agency.
<b>Franchising</b>	A form of contracting out whereby government confers the right or privilege to a private concern to conduct a business or sell a product or service in a specific geographic area according to prescribed terms and conditions.

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<b>Government Owned / Contractor Operated (GOCO)</b>	An organizational and commercial arrangement where a government-owned facility is operated by a third party, usually a for-profit contractor.
<b>Licensing</b>	A variation of contracting out through which government grants a license to a private concern to sell a product or service that would not otherwise be allowed outside the public domain.
<b>Line Organization</b>	A conventional department, division, branch, section, or other vertically integrated business unit. Tends to be used to perform inherently governmental activities.
<b>Machinery of government.</b>	The structure of government and allocation of functions to Departments and Ministries.
<b>Mainstream Ministry/agency-level functional review</b>	An efficiency and effectiveness review considering the reshaping of some programs, dropping of some activities, and restructuring some entire agencies but without large scale changes to the machinery of government
<b>Private, Not-for-profit Agency</b>	A formal agency volunteer program or a private non-profit service organization in which volunteers provide all or part of a service, either independently or under government direction.
<b>Privatization</b>	Shifting functions, in whole or part, from government to the private sector when there is no continuing public policy reason to retain responsibility within government.
<b>Public Partnership</b>	An intergovernmental agreement in which two or more jurisdictions contract with each other to deliver public programs or services.
<b>Public/Private Partnership</b>	A cooperative or joint venture between two or more parties in the public and private sectors, built on the strength and expertise of each partner.
<b>'Pure' efficiency review</b>	An efficiency and effectiveness review envisaging no major changes in government policies and programs, assuming that organizational and business process changes can generate the same outputs at greater efficiency
<b>'Pure' policy or program review</b>	An efficiency and effectiveness review envisaging comprehensive policy reforms, with only a passing interest in organizational level arrangements.
<b>Service Shedding</b>	A form of divestiture that occurs when government reduces the level of service or stops providing a service altogether due to lack of demand, insufficient resources, or the desire to reduce the size of government.
<b>Shared services</b>	A form of public partnership involving a joint service agreement where two or more levels of government (for example federal and provincial) act together to plan, finance, and deliver a public service.
<b>Special Operating Agency (SOA)</b>	A service operation within government granted more direct responsibility for results and increased management flexibility needed to reach new levels of performance in Canada. It is an example of a supervised body or executing agency.
<b>Statutory commissions and independent regulators</b>	Agencies are "statutory commissions" when that they have a well-defined separate legislative existence. Their objectives are often enshrined in a charter, and their functions are defined by legislation in addition to any powers of direction held by the Minister. They may also be non-asset owning (legally distinct but unable to own assets) or asset owning. They can be budget dependent (subvented) or collect significant revenue earnings. They can also have legal competence to enter into contractual relationships.
<b>Supervised bodies or executing agencies</b>	Executing agencies reporting to Ministries (or reporting to Ministers but under the day-to-day supervision of a Ministry) are often indistinguishable from the state in the legal or constitutional sense. However, the relevant Minister generally defines their objectives (perhaps in a framework agreement) and their source of funding can include some revenue earnings. Executing agencies rarely have legal competence to enter into contractual relationships with suppliers.
<b>Upstream program and efficiency review</b>	An efficiency and effectiveness review that envisages comprehensive policy reforms, shifting from low to high priority programs, and the restructuring of government-wide processes including large scale restructuring of the machinery of government.
<b>Utility</b>	A system, works, plant, pipeline, equipment, or service operated by government in the public interest.

## **Appendix 1      Country examples**

### ***Brazil – inventory of government programs***<sup>12</sup>

Brazil introduced a program budget format to re-examine all government activities. The process inventoried and mapped activities into 380 programs with common goals and performance indicators to monitor progress. Program definition was based upon dialogue between each ministry and the Ministry of Planning as part of the federal government's 2000-2003 multi-year plan and budget preparations. The quality of dialogue depended on central specialists' knowledge of their sector and bargaining relations with ministries. While the Ministry of Planning provided the framework, the pace and exact form of implementation were left to each ministry. Program design continued to be rationalized during the first year of implementation, since organizational changes had not materialized in most ministries. Some states were starting to adopt the process.

The pivotal question is, "What are we doing, and does it lead to any meaningful outcomes?" The government has explicitly shied away from an exercise that results in target driven program cuts. The initiative has also been timid in identifying alternative modes of operation, such as contracting out. Ministries are pursuing these measures through parallel efforts, like ongoing health sector modernization and decentralization. The World Bank considers this a sensible strategy because any reform that pushes cutting and reorganization is likely to encounter overt opposition and covert resistance within the vast federal bureaucracy.

### ***Canadian reviews:***

#### ***Government of Canada – 1994 program review***<sup>13</sup>

Program Review presented a new government early in its mandate with an opportunity to start fresh. The process was orchestrated centrally to review all government programs, including those implemented by central agencies, according to six criteria: public interest, role of government, jurisdictional alignment, external partnership, business principles, and affordability. Public expectations were managed by making the public aware of the dangers of doing nothing, informing the public of the advantages, and avoiding public debate on technical design. Public servants were kept involved and motivated by creating a sense of urgency, avoiding complexity, and promoting visibility. Bargaining with sub-national governments and other sectors featured concessions to ease offloading and contracting of federal responsibilities. Savings of \$3.9 billion on a 1995/96 budget of \$52 billion, rising to savings of \$7.2 billion in 1996/97, were realized.

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<sup>12</sup> See (Wilkins 2001)

<sup>13</sup> See (Armit and Bourgault 1996; Aucoin and Savoie 1998)

*Government of Canada – ongoing Alternative Service Delivery reviews*<sup>14</sup>

As one concrete product from an otherwise somewhat discredited earlier reform program (*Public Service 2000*), Special Operating Agencies (SOAs) were conceived in 1990 as a method for the federal government to improve service and reduce costs in selected programs. SOAs allowed the semi-corporatization of some Departmental activities into business units with greater managerial flexibility but within the public sector.

Following a change of government in 1993 and Program Review in 1994-95, stocktaking of the initiative resulted in some SOAs being merged back with their parent departments, some being privatized, and most being retained within tighter parameters. The total number of federal SOAs has remained at 20, but many of Canada's provinces and some cities have adapted the concept successfully, most notably in Manitoba and Winnipeg.

The 1994 Program Review was a one-time, time-limited, comprehensive adjustment, but it was followed by ongoing Alternative Service Delivery (ASD) reviews. These lacked the political will, central coordination, and target setting of Program Review. Unlike the UK policy of creating a civil service of executive agencies or the New Zealand policy of wholesale commercialization and privatization of government entities, there was no preconceived outcome for the ASD reviews.

Responsibility for ASD reviews lies with the Treasury Board of Canada Secretariat. The ASD Division has developed a policy and guidelines on the federal ASD framework. Departments and agencies are encouraged to continually review their programs to ensure they are still relevant and are being carried out in a way that best achieves national objectives. The principles guiding this examination are related to the public interest, service quality and client orientation, resource management, and human resources. Issues reviewed with central agencies include public policy, impact on the fiscal framework, change in accountability, legal constraints, significant human resource effects, and cross-departmental implications.

Programs are reviewed on a case-by-case basis, in consultation with the other central agencies. Treasury Board or Cabinet suggests candidates and an initial feasibility study analyzes the options, and selects the best. A proposal is submitted to Treasury Board or Cabinet to implement the department's preferred option.

The impact of the ASD initiative has not been measured consistently across the federal government. Results to date include:

- Creation of additional SOAs, including six in Industry Canada;
- Establishment of three legislated service agencies (revenue, food inspection, parks);
- Facilitation of partnerships through amendments to the Financial Administration Act;
- Outsourcing of property management functions, with projected savings of \$40-50 million;

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<sup>14</sup> See (Treasury Board of Canada Secretariat 2001; Wilkins 2001)

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- Conversion of civil air navigation to a not-for-profit corporation;
- Negotiation of six employee takeovers with the National Capital Region Commission; and
- Privatization of government printing and publications.

### *Province of Alberta – Alternative Service Delivery reviews<sup>15</sup>*

The Province of Alberta ASD review has helped government find more cost-effective ways of operating. The program has used a variety of delivery options, including privatization, contracting, and devolution to municipalities. In the past decade, Alberta has outsourced information technology, hunting and fishing licenses, electricity, liquor sales, highway maintenance, and motor vehicle licenses.

Guidelines on requests for proposals and contract administration are provided to ministries and agencies interested in outsourcing services. The procedure calls for review of strategic plans, performance information, delivery options, cost-benefits and risks, human resource implications, action plans, and communication strategies. So as not to sacrifice service quality to economy, issues of performance, finances, stakeholder interests, contract administration, complexity, and timing are considered in the overall assessment of alternatives.

The outsourcing process has spread quickly throughout Alberta, fueled by encouraging results and government downsizing. Claims have been made about improved service quality and reduced costs.

### *Province of Manitoba – Alternative Service Delivery reviews<sup>16</sup>*

In 1991, the Province of Manitoba embarked upon a ASD reviews as a different approach to evaluating public programming and spending. The Province designated seventeen SOAs in nine departments in seven years.

The Province passed enabling legislation to designate SOAs by regulation and to establish the governing body attached to Treasury Board to fund and account for SOAs outside mainstream government.

SOAs are service operations within government granted more direct responsibility for results and increased management flexibility needed to reach new levels of performance. They are semi-autonomous agencies situated along an organizational continuum between a line department and Crown corporation. Ideal candidates are those organizations best held within government in the public interest but which require greater freedom to manage in a more business-like way. Candidates can be direct public services, internal services to government, science and technology services, or regulatory and enforcement programs.

The Manitoba SOA balanced scorecard to 1999/2000 indicates significant operating efficiency improvements as a result of ASD initiatives:

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<sup>15</sup> See (Wilkins 2001)

<sup>16</sup> See (Wilkins 2001)

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- \$26 million (33%) new revenue and \$20 million (17%) annual cost-savings, resulting in retirement of \$11 million in provincial debt and sharing of \$34 million in surpluses with the Province.
- 208 new private sector jobs and \$100 million in new economic development activity leveraged in the provincial economy.
- 44% more service selection and 46% more service volume, 90% of which was provided on time to 120% more clients, with 93% client satisfaction and 100% client retention.

### ***Province of New Brunswick – Program and Service Review***<sup>17</sup>

In 1999, the Province of New Brunswick approved a process for a Program/Service Review designed to systematically assess all government programs. The mandate of the task force was to reduce areas of waste, duplication, and overlap as the basis for future policy and funding priorities. The review was guided by five questions dealing with the role of government, relevance to provincial objectives, competitiveness, efficiency, and affordability.

The review entailed four phases: identification and description, functional grouping, priority setting, and impact assessment and implementation. Over 600 services were identified, profiled in detail, and sorted into twelve horizontal groupings. Service groupings were evaluated to differentiate essential and non-essential programs. The latter were either discontinued or considered as ASD prospects. The initial results were reflected in the restructuring of government departments announced in the 2000/01 Budget. The Department of Finance, for example, had lottery, liquor, and tobacco regulatory responsibilities transferred to the Department of Public Safety but retained responsibility for lottery policy.

### ***Province of Ontario – ongoing Alternative Service Delivery reviews***<sup>18</sup>

In 1996, the Province of Ontario introduced an ASD initiative with a standardized format and central approval process for ministries. A new government had called for a more business-like, results-based approach to what remains in government and greater involvement by the private sector in delivering public services. Government would pursue alternatives, such as public/private partnerships and opening government to outside competition. ASD was an important part of the strategy to enable ministries to deliver affordable, accessible, and responsive programs and services.

Candidacy was voluntary and guidelines were issued that explained the principles, options, and criteria and to help ministries choose the most appropriate delivery option for a program. The options discussed include privatization, partnerships, licensing/franchising, external purchase of services, devolution, agencies, and direct delivery by government. Ministries are expected to prepare business plans, setting out their restructuring strategies, with proposals to:

- terminate programs;
- continue direct delivery of redesigned programs; and

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<sup>17</sup> See (Wilkins 2001)

<sup>18</sup> See (Wilkins 2001)

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- use alternative approaches to deliver redesigned programs more efficiently and effectively.

The framework sets out guiding principles, the decision tree for program review, criteria for selection of a delivery option, accountability considerations, ASD options, and the approval process. The criteria for determining the optimum delivery option take into account the public interest, decision-making autonomy, financial autonomy, management and administrative flexibility, applicability of market forces, and cost-benefit analysis.

A guide provides ministries with the format for selecting cost-effective delivery options. Preparation of a ministry business case is a decision-making requirement for ASD selection. It is a systematic approach to comparing the costs and benefits of current and alternative methods of delivery.

### *Province of Quebec – Autonomous Service Unit program*<sup>19</sup>

The Province of Quebec has created a program of creating Autonomous Service Units (ASU). They borrow from the example of UK executive agencies and Canadian SOAs. Managers are granted more freedom and authority but are held more strictly accountable for results. The best candidates have an operational role, measurable performance, a clear mission, stable policy, and sound financial management.

Fifteen ASUs have been established in broad areas of provincial programming since 1995. These include programs as diverse as aircraft and vehicle fleets, parking, scientific laboratories, rent regulation, environmental analysis, student aid, employment, forestry, conservation, mineral research, tourism, and revenue collection. Quebec also considers partnership, devolution, and contracting options in assessing services.

The focus on performance indicators, information systems, and training has helped ASUs to become efficient and innovative. There are many reported instances of cost-savings to government, productivity gains, and improved service quality. However, ASU proponents are frustrated by inadequate resourcing and unresponsive support services from departments and central agencies.

### *City of Winnipeg – Management Reference Model reviews*<sup>20</sup>

Early in 1998, the city adopted a framework for a case-by-case review of City services to evaluate the most appropriate mechanisms for delivering affordable, responsive, and sustainable services. This framework established the ground rules and direction for a consistent approach to ASD decision-making and summarized the approval process for ASD development. The city delegated an ASD committee to prioritize, review, and evaluate candidates.

The city adopted an innovative business modeling software called the Management Reference Model for Government Services (MRM/GS). The MRM/GS identifies

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<sup>19</sup> See (Wilkins 2001)

<sup>20</sup> See (Wilkins 2001)

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activities, resources, and internal services that support public services, maps organizational roles, responsibilities, authorities, and accountabilities, and links public services to program outcomes.

During 1998-99, the MRM/GS was completed across all City departments, resulting in service descriptions for 260 discrete public services. This information allowed the City to define core versus non-core services and to set service baselines and targets.

### ***Jamaica – agency modernization diagnostic reviews***

In 1998 and 1999, diagnostic reviews were undertaken to prepare 19 entities into UK-style 'Executive Agencies' and modernize their operations. These entities were chosen by the government on account of the significance of the services they provide. The agencies reviewed were:

1. Planning Institute of Jamaica (Ministry of Finance and Planning).
2. Jamaica Customs Department (Ministry of Finance and Planning).
3. Office of Titles (Ministry of Environment and Housing).
4. Town Planning Department (Ministry of Environment and Housing).
5. Surveys Department (Ministry of Environment and Housing).
6. Jamaica Information Service (Office of the Prime Minister).
7. JAMPRESS (Office of the Prime Minister).
8. Registrar General's Department (Ministry of Health).
9. Registrar of Companies (Ministry of Industry, Investment and Commerce).
10. Administrator General (Ministry of National Security and Justice).
11. Management Institute for National Development (Efficiency and Reform Directorate, Office of the Prime Minister)
12. Jamaica Promotions Corporation - JAMPRO (Ministry of Industry, Information and Commerce).
13. Construction Division of the Ministry of Local Government and Works.
14. Registrar General's Department
15. Registrar of Companies
16. Administrator General
17. Management Institute for National Development
18. Planning Institute of Jamaica
19. Construction Division of the Ministry of Local Government and Works

The diagnostics led to: a Modernization Plan for each agency, indicating the nature, timing and cost of various activities to be undertaken; a Medium-Term Financing Plan, indicating the estimated receipts, expenditures and sources of financing for the next 5 years; and a Framework Document, indicating the respective rights and obligations of the government and the management of the agency.

### ***Jordan – functional review of the Department of Administrative Development***

A functional review was undertaken in 1999 following the merger of some central agencies to create the new Department.

***Kazakhstan – 1998 functional review***<sup>21</sup>

Kazakhstan, as part of a public sector reform program, undertook a Functional Review in response to a 1998 revenue shortfall and the need to cut 1999 budgets. The objectives were to:

- align state functions with the aims of a market-oriented economy, constitutional obligations, and social priorities;
- eliminate any inappropriate functions; and
- restrict funding of functions to resource levels likely to be available in the 1999 budget.

The Budget Commission, headed by the First Deputy Prime Minister, proved to be a robust oversight body for the inherently political process underlying Functional Review. It was effective in carrying out consultations behind the scenes and in dissipating tensions. Meanwhile, the process managed by the Ministry of Finance featured:

- systematic review of all budget-funded entities by function;
- classification of all budget entities as state management or commercial service functions;
- subdivision of commercial service functions into services mandated on the state and contestable services;
- corporatization and hiving off of contestable commercial services into Non-budgetary State-owned Enterprises (NBSOE) under contract to budgetary entities;
- elimination of unfettered authority to create and staff commercial service functions;
- amendment of the civil code to define different types of entities and facilitate corporatization;
- attempted consolidation of budgetary entities' off-budget revenues into the budget; and
- special arrangements in the health and education sectors to promote competition for contestable services and to legitimize through user charges formal and informal payments.

The outcome of the process was proposed staffing reductions of 23,762 positions (25%) for apparatus of central executive bodies, 2,064 positions for other budgetary state entities, and 302,783 positions taken off budget for 600 proposed NBSOEs. Kazakhstan anticipates clearer functional definition, considerably fewer budgetary entities, a lower wage bill, reduced administrative expenses, enhanced Ministry of Finance capacity for post-management, and uniform staffing standards across ministries. The process has already been effective in linking the review with reform of the budget process.

Kazakhstan is known among former Soviet Union transition countries as the "master of agency creation" for its NBSOEs. The review validated concerns about contracting out services on a large scale in the absence of a substantial private sector and without an institutional framework and capacity for managing contracts. NBSOEs are mandated to offer residual services outside government. They apply an implicit

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<sup>21</sup> See (Wilkins 2001)

subsidy to the private sector and build up fresh arrears whenever they operate on less than full cost recovery. The extent to which the government budget is obliged to cover their liabilities is not clear. State control can be illusory when the mechanisms for enforcing contracts, within and outside government, are weak.

***Latvia – 1999 functional review of the Ministry of Agriculture***<sup>22</sup>

During 1999-2000, Latvia conducted ministry-based Functional Reviews in agriculture, economics, and justice. The Bureau for Public Administration Reform wanted to develop a methodology that could be used by ministries to review the relevance of their functions and associated structures. The Ministry of Agriculture agreed to pilot the methodology prior to implementing reviews in other sectors. All central ministry and agricultural subsidiary and territorial bodies, including education establishments, were considered within the review, although it did not examine self-financing fisheries enterprises or state forestry subsidiaries being reviewed separately.

The methodology was developed in partnership with international and local consultants, together with a ministry working group. Interviews were conducted with over 100 sector stakeholders using a structured questionnaire to identify existing functions. Each function was tested against a custom-designed analytical framework to determine how they should be treated. Draft proposals were reviewed in workshop with departmental heads to prepare realistic recommendations.

The review resulted in comprehensive ideas for abolishing, rationalizing, privatizing, and transferring functions within the agriculture sector, together with recommendations on how remaining and new functions could be restructured into effective organizational units for the medium and long term. The report proposed that the central ministry structure be modified to ensure clear separation of strategic planning and policy support functions. It was further recommended that strategic planning, institutional reform, and European Union integration functions be unified to ensure effective coordination of sector policies. Performance agreements managed by central ministry operations directors in each sub-sector are intended to strengthen weak accountability arrangements for subsidiary bodies.

The review identified 161 separate functions, of which nine were pegged for privatization, 40 for rationalization, and twelve for transfer to other sectors. The effect was to reduce the number of ministry-funded staff from 8,280 to 3,196, with 4,891 positions privatized or transferred. There is a 6% net reduction in remaining positions due to internal reorganization. Streamlined decision-making, improved policy-making and implementation, and strengthened accountability for subsidiary institutions are expected.

A follow up evaluation (István 2000) confirmed that the process of reorganization closely followed that proposed by the review and that resistance to implementation among staff was relatively low due to a good understanding by staff of the methodology of the plan's preparation. The final structure of the Ministry was influenced rather than determined by the review, and senior managers accepted the

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<sup>22</sup> See (1999)

methodology and have become "owners" of most of the findings and recommendations.

***Macedonia – 2001 wage bill reduction review***

Details are provided in section 1 of the paper.

***New Zealand – reviews of the State Sector***<sup>23</sup>

The Government Management: Brief to the Incoming Government 1987 (New Zealand Treasury 1987) was a remarkable document. (Schick 1996) offers a detailed analysis. In essence this was a Treasury-led comprehensive review of the policies of successive governments in the light of what it saw as the intrinsic tendency of state organizations to "pursue their own goals, to shirk and to featherbed" (New Zealand Treasury 1987, p.38). From an explicit set of propositions concerning what the state was and was not good at doing, and concerning the arrangements that the state should use to undertake those (fewer) tasks that it should retain, the review then proposed both radical reforms in the policies of government and in the machinery of government necessary to undertake those policies. The review was an expert-based, top-down review undertaken without the participation of the line agencies.

As is well known, the subsequent reform process followed two main strands (Boston 1996; Boston, Martin et al. 1996; Manning 1995):

- State trading bodies were transferred from the core public sector into commercially driven public corporations. SOEs have substantial managerial autonomy under performance agreements with ministers. The purchase, supply, and subsidization of agency outputs are controlled through measurement of government strategic results and agency key results. There are clear incentives for performance. Many SOEs were privatized to the benefit of taxpayers and government economic and social policies.
- The remaining core public service and financial management regimes were reformed. Policy advice was separated from service delivery functions for many departments. Chief executives have time-limited contracts and specific performance agreements with ministers. Major restructuring in many sectors resulted in a 50% downsizing of the public service. Accrual accounting and charging for the capital invested in Crown organizations were part of the reform package.

(Steering Group 1991) was an associated follow-up review that reported on the subsequent implementation of the comprehensive New Zealand reforms, with a strong emphasis on accountability rather than efficiency. This was also an expert-based review, reporting directly to a Cabinet Sub-committee with quality control provided by a small project management group including officials from a range of departments. The review used interviews with ministers, group interviews, and a survey of chief executives, supplemented by case studies.

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<sup>23</sup> See (New Zealand Treasury 1987; Steering Group 1991)

***Nicaragua – structure and function diagnoses***<sup>24</sup>

In Nicaragua, structure and function diagnoses of nine government agencies led to a program of emergency cuts and a new executive branch organization law streamlining central government. Project direction for Functional Review comes from the Vice Presidency.

***Papua New Guinea – functional reviews***<sup>25</sup>

Papua New Guinea is conducting an extensive Functional Review as part of its public sector reform program. Reviews of treasury and finance, foreign affairs, central supplies, tenders, defense, and civil aviation functions have been carried out under the direction of the Public Sector Reform Unit in the Prime Minister's Office, with outside consultancy assistance. Reviews of other central agencies (personnel management, public service commission, Prime Minister and Cabinet, and planning and monitoring) are underway. Major spending and service delivery agencies (health, education, public works, lands) will come next.

The boundaries of each review are very wide. They tackle policy issues and exercise lateral thinking in diagnosing what needs fixing. Some expenditure cuts have been identified and are expected to be fed into the 2001 budget process. It is less clear how many of the proposed cuts will actually be implemented.

***Tanzania reviews:***

***Review for agency status***<sup>26</sup>

In 1994, Tanzania decided that eleven trading functions should become executive agencies to improve public service delivery and earn their own operating expenses. These included the government press, central medical stores, radio broadcasting, electrical and mechanical, and companies registrar. With the exception of the central medical stores where the World Bank provided technical and financial support, none of the candidates made any real progress.

Under the direction of the Civil Service Department and with technical assistance from the UK, Tanzania launched the Executive Agencies Project in 1997. The principal constraint to progress under the 1994 initiative was identified as lack of a clear policy framework within which agencies could be set up and operated. In other words, the government and agencies had started doing even before they had clearly thought through what needed to be done.

Before setting up any agencies under its 1997 framework, the government decided to consider the process for assessing service delivery options, along with a host of other policy fundamentals. Abolition, privatization, contractorization, and rationalization were the alternatives to agency status assessed. Clarity, self-sufficiency, modern management practices, client satisfaction, and continuous improvement criteria were

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<sup>24</sup> See (Wilkins 2001)

<sup>25</sup> See (Wilkins 2001)

<sup>26</sup> See (Wilkins 2001)

used to determine the best delivery option for each candidate. This examination also ensured that only essential government functions were retained and that executive agencies were differentiated from other forms of government-owned or funded organizations like parastatals. The case was set out in an Alternative Options Paper for approval by the ministry and notification of central authorities.

The government adopted an "eyes on, hands off" approach, emphasizing that agencies' parent ministries would be watching what was going on at a strategic level but would not get involved in day-to-day operations. A small advisory board was also set up for each agency. Working within this framework, three organizations were made executive agencies by April 1999: the civil aviation authority, the dams and drilling organization, and the national bureau of statistics. Another 35 organizations have been reviewed and recommended as agency candidates.

***Organization and efficiency reviews<sup>27</sup>***

In 1996, with extensive donor funding, the Government instituted "organizational and efficiency reviews" to prepare recommendations for (i) reorganizing the structures of Government ministries and departments "with a view to improving efficiency and effectiveness in the deployment of personnel, utilization of resources, internal decision-making processes and communication systems", (ii) identifying "opportunities for efficiency gains in Government through the application of norms in staffing and improved work methods", (iii) identifying "feasible opportunities for cost recovery and improved budgetary allocations in the delivery of specific services by the Government", and (iv) improving "the government's management systems (i.e. planning, budgeting, public administration, project implementation, personnel management)".

The reviews were undertaken by an expert team and began by evaluating how each ministry and department "should be organized", given its redefined roles and functions. The reviews drew on the 1992 Study on the Functional Review for Ministries, Regions and Districts that was carried out under a UNDP funded project.

The review of each ministry or government department was envisaged as a two-stage process. Phase 1 was an analysis and consideration of the role of government and the consequent institutional development requirements arising from that role. Phase 2 was to build on the review process, leading to an articulation of the various measures required to build (or re-build) the ministry. Phase 1 comprised:

- (a) A review of the current operations of the ministry/department at the central, regional and local administration levels with particular focus on the relevance, scope and level of service being provided and the efficiency of operations;
- (b) An analysis of the main issues and their policy and strategic implications;
- (c) Identification of the role of government consistent with current policies for economic liberalization and for reducing the functions of the public sector in the provision of economic services;
- (d) An investigation of the opportunities and scope for cost-sharing and enhanced cost recovery for services that should continue to be provided by the government.

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<sup>27</sup> see: (Civil Service Reform Programme Steering Committee 1996a, b, c, d, e, f, g, h, i, j)

***Thailand – 2000 functional reviews***<sup>28</sup>

Thailand has embarked on Functional Review as a key activity in its public sector reform program. Reviews in 2000 of its six economic ministries identified requirements for process reengineering in the commercial registration and lands areas, as well as reforms in revenue, customs, and social security. Service users were involved in the process to help develop a client focus and improve performance. In practice, the reviews focused more on rearranging boxes than on analyzing proper ministry functions and fundamental issues like ceasing, contracting out, or layering operations.

Nor have the reviews been well integrated with broader reforms needed to ground key decisions on fewer staff and reduced costs. Civil service staffing has been targeted for a 10% reduction by 2002. The latest forecast indicates that only a 3% reduction is achievable based on current measures. The means of attaining the downsizing target has shifted to transferring staff to local administrations.

***UK reviews:***

***Prior Options reviews***<sup>29</sup>

Since 1988, the UK has established more than 140 Executive Agencies, comprising 75% of the civil service. The Next Steps initiative was driven by the Prime Minister's Office and managed centrally through a formal selection process. The design of the agencies encompasses framework agreements, annual performance agreements, performance pay, advisory boards, and three-year evaluations. Chief executives report to a minister but can answer questions in public and before Parliament.

The creation of Next Steps agencies was one of the options that emerged from the systematic application of "Prior Options" tests to ministries and departments. The questions asked in these tests are:

- Is the function provided in the past still needed, or can it be abolished?
- If the function is still needed, should it be privatized or financed publicly?
- If the function should be public, can the work be contracted out?
- If government should provide and finance the function, can mainstream government or an executive agency deliver it more cost-effectively?

A multi-ministry review team carries out the Prior Options Review according to a common process and methodology. In addition to central agency quality control, an advisory group is attached to the review. Issue papers, terms of reference, and the full findings are published. An executive agency is only established once the minister responsible rules out all other options.

The principles under which Next Steps agencies are created require that their status be reviewed every five years. A further Prior Options Review is carried out according to Cabinet Office guidance and an agreed timetable. These reviews:

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<sup>28</sup> See (Wilkins 2001)

<sup>29</sup> See (Wilkins 2001)

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- Re-examine the options considered before creating the agency in light of experience and any changes in internal and external circumstances;
- Test rigorously whether the agency function is required at all, or whether there is any scope for privatization, contracting out, transfer to another body, repatriation to the department, or continuation of agency status;
- Consult widely with agency management and staff, the parent ministry, customers, interest groups, and other suppliers of similar services;
- Assess the practicability and value for money of each option; and
- Make recommendations to the minister responsible.

The public and interested parties are invited to participate through their comments, while alternative suppliers can submit proposals when solicited through market testing.

### *Better Quality Services and Best Value Reviews*<sup>30</sup>

The aim of these reviews is to set improvement targets and to determine the best option for delivering "best value". The principles of the reviews are most simply described as: Challenge, Compare, Consult and Compete.

- Challenge why and how a service is being provided;
- Invite comparison with others' performance across a range of relevant indicators, taking into account the views of both service users and potential suppliers;
- Consult with local taxpayers, service users and the wider business community in the setting of new performance targets; and
- Embrace fair competition as a means of securing efficient and effective services.

For central government, Better Quality Services Reviews cover a specific service or part of a department (e.g. HQ personnel function) rather than the whole organization. The aim of each review is to reconsider what service is needed, in consultation with users, and then identify the best supplier to deliver both cost and quality gains year on year.

Each BQS review considers the following five options:

- Abolition;
- Internal re-structuring;
- Market testing;
- Privatization; or
- Strategic contracting out.

Local governments must devise a program of Best Value Reviews and publish them in a "Best Value performance plan". The programs must cover all Council services and activities, over a 5-year cycle (although in the Act, the actual time is left to the Secretary of State to prescribe by Order). There are wide powers to the Secretary of State to prescribe by Order not just the timetable, but for specified functions to be reviewed in specified financial years. The Secretary of State may also make different provision in relation to different authorities.

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<sup>30</sup> See (Cabinet Office 2000a, b; Department of Environment 2001; Improvement and Development Agency 2001)

Councils may choose how to program their reviews, so long as they make, in the words of the White Paper, 'early inroads' into the weakest services. They may choose to prioritize reviews in areas:

- which are particularly significant in budget terms and there is considerable scope for improvement,
- where local people have a particular interest or concern,
- which face legislative change,
- which are subject to new government policy initiatives,
- which are subject to new bidding regimes,
- where innovation is sought,
- where a new cross-cutting approach is to be tried, or
- where a contract is due for re-tendering.

They will have to be able to provide reasons for the order and priorities within the program.

One of the goals is to encourage programs of reviews on a cross service and/or multi-agency basis including those that address 'wicked issues' such as sustainable development or community safety.

### ***Market Testing***<sup>31</sup>

Market testing is the procedure introduced in 1991 to determine the feasibility and efficiency of contracting out services. It can be compared with make-or-buy decisions in business used to leverage cost-savings, innovation, and quality. Ministries were required to review their activities to identify which ones should be put to tender for bids from both public and private sector sources. They brought in private sector help to analyze the most promising areas for privatization and contracting.

The questions asked include:

- Is this function essential? What are the implications of not doing it, or of doing it in a reduced or combined way elsewhere?
- Can the function be performed more economically by other means?
- What is the full cost of the service level currently provided and of that considered necessary?
- Is the function organizationally discrete?
- What are the work methods, organization, and use of capital assets?
- What are the plans for utilizing existing staff and assets?

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<sup>31</sup> See (Wilkins 2001)

***Fundamental Expenditure Reviews***<sup>32</sup>

By 1993, the UK had largely decentralized service delivery and devolved central management responsibilities to executive agencies. Smaller ministries had fewer resources to meddle in agency affairs, focusing instead on strategic management decisions and enforcing accountability frameworks. Fundamental Expenditure Reviews were developed as a tool for ministry downsizing and realignment.

The Treasury took a top-down stance in reviews to examine long-term spending trends, alternatives for more economic and effective service delivery, and opportunities to withdraw services altogether. These reviews were policy driven and did not take any element of a ministry's work arrangements for granted. The issues at stake included:

- Why is the service provided? Is it provided in the right way?
- What methods of consultation exist? What improvements are planned?
- What measures are available? How does performance compare to the best?
- What competitive alternatives are available? Should new alternatives be created?

Ministries undertook their own reviews within a phased program covering major areas of government spending. Prodded by cuts in operating budgets, they were forced into asking what was worth doing and what should be divested or delegated. The Treasury itself conducted a Fundamental Expenditure Review on its running costs, including a detailed review of the senior management structure. The review resulted in revised departmental objectives, core functions based on Treasury staff's comparative advantage, transfer of remaining civil service management functions to the Cabinet Office (OPS), a streamlined top management structure, a flatter and more roles based team structure, and a reduction in senior staff posts from 100 to 75.

***US reviews:***

***'Bottom Up' review of the Department of Defense***<sup>33</sup>

The Secretary of Defense was requested by the President in 1993 to prepare a review of military needs of the United States over the coming 10 years. The two fundamental issues to be addressed by the review were:

1. The continued justification for nuclear weapons following the end of the cold war;
2. The structure of the military to deal with regional conflicts.

The Review was widely seen as a defensive maneuver by the Department of Defense as it led to a justification of existing spending.

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<sup>32</sup> See (Wilkins 2001)

<sup>33</sup> See (General Accounting Office 1995; Peters and Savoie 1998)

## **Appendix 2 Principles and assumptions**

Efficiency and effectiveness reviews draw their recommendations from some principles and assumptions concerning the best way for the state to ensure the achievement of its priorities. 'Best' is of course a complex notion when there are many conflicting goals. The organizational arrangements and incentives that maximize operational efficiency, do not automatically lead to improvements in equity and accountability.

The key to an effective review is to make the principles and assumptions that underpin the review explicit, so that they can be challenged and improved. This Appendix presents many of the principles and assumptions in common usage, and explains their origins. Relatively few of them are supported by robust empirical evidence.

### ***Critiquing social and sectoral programs***

(Wilkins 2001) provides a useful checklist of the key questions to determine whether and where government programs should be amended.

#### **1.0 Public Interest Test: *Does the program or service continue to serve a public interest?***

- 1.1 Does the program deliver a product or service that is essential in meeting future public needs?
  - Who are the clients and stakeholders of the program or service?
  - How do the clients and stakeholders benefit from the program or service?
- 1.2 Is the program or service necessary to fulfill the legal mandate of the organization at large?
  - Is the program mandate consistent with the organizational mandate?
  - How does the program or service contribute to protecting a greater interest?
- 1.3 What is this program's relative contribution to the public interest based on its overall societal benefits and costs?
  - Do the benefits of the program or service (e.g., reduced direct costs, reduced overhead costs, more consistent quality, improved convenience) exceed its costs?
  - Do equity considerations (e.g., fairness to suppliers, regional economic benefits) justify costs exceeding benefits?
  - What would be the implications of discontinuing the program or service?

**2.0 Role of Government Test:** *Is there a legitimate and necessary role for government in this program or service?*

- 2.1 Is there an appropriate role for government or the broader public sector to play?
- Do clients, stakeholders, and the general public believe that government should be managing or delivering this program or service?
  - Is the rationale for the program or service still relevant?
  - To what extent does the program or service require or involve close political direction?
- 2.2 What would be the impact of abandoning this program or service?
- What would be the consequences to clients, stakeholders, the public, and employees if the policy development and management of the program or service were devolved to the private or voluntary sector?
  - What would be the consequences to clients, stakeholders, the public, and employees if the operational delivery of the program or service were devolved to the private or voluntary sector?

**3.0 Jurisdictional Alignment Test:** *Is the lead responsibility for this program or service assigned to the right government jurisdiction?*

- 3.1 Why is the government present in this area?
- Is it a legislated responsibility?
  - Do other jurisdictions deliver similar programs or services, or have they expressed any interest in delivering them?
  - Could satisfactory results be achieved if the program or service was delivered by another public sector jurisdiction, and at what cost?
- 3.2 Would there be better value provided to taxpayers if the government responsible for this program or service took over some or all related responsibilities from other jurisdictions?

**4.0 External Partnership Test:** *Could, or should, this program or service be provided in whole or in part by the private or voluntary sector?*

- 4.1 Could satisfactory results be achieved through private or voluntary sector action, and at what cost?
- Is it reasonable to expect that a partnership between the private or voluntary sector and the government could be arranged to deliver the program or service?
  - Is there a suitable potential partner who has expressed interest?

- Could such a partnership achieve satisfactory results?
- Would such a partnership be in the public interest?

4.2 Under what conditions and at what cost could or should the program or service be transferred?

- What would be the respective roles of the government and the private or voluntary sector partner?
- What would be the benefits, savings, and costs to the government of entering into such a partnership?
- Under what conditions and at what cost should the program or service be transferred?
- What might be the impact (e.g., cost, access, service, satisfaction, risk) of such a partnership on clients, stakeholders, the public, and employees?
- How long would the selection and negotiating process take the government to complete?

**5.0 Business Principles Test:** *If the program or service continues within the existing government context, how could its efficiency and effectiveness be improved?*

5.1 What changes could be made to the program or service to provide equal or superior service at lower cost?

- Are there ASD options that could be considered further for the program or service?
- Could expanding the program's scope or mandate across departments and/or other orders of government reduce the net cost to taxpayers?
- Are there program or service initiatives (e.g., single window delivery, information technology, business process reengineering, continuous improvement, total quality management) underway, planned, or being studied that will positively affect efficiency?
- Is a reduction in program overhead possible?
- What other changes could be made to the program or service to provide equal or better service at lower cost?

5.2 How could the program or service be restructured to improve cost-effectiveness?

- Is there adequate accountability based on a clear mandate, known decision-making authority, and measurable performance?
- Does the program or service display sufficient adaptability to change in terms of leadership, policy environment, planning preparedness, stakeholder consultations, employee involvement, and scope and scale of operations?
- To what extent does the program or service require management and administrative flexibilities as incentives for more efficient and effective delivery?

- Would a different organizational form within government work better and cost less?
- How could the program or service be coordinated more effectively with other parts of government to share delivery responsibilities?

5.3 How entrepreneurial should the program or service be to fulfill its mandate?

**6.0 Affordability Test:** *Is the program or service affordable within fiscal realities?*

- 6.1 Is the program or service, which is considered essential to serve the public interest and represents an appropriate and necessary role for government, affordable given the available financial resources?
- Can a lower level of service be provided that still satisfies the public interest?
  - To what extent does the program or service rely on government funding versus accessing funds from other sources?
  - Should alternative sources of funding for the program or service be considered (e.g., user fees, cost-shared agreements, endowments, equity)?
- 6.2 If the program or service is affordable within current fiscal restraints, is it sustainable for the foreseeable future?
- 6.3 If the program or service is not deemed affordable, should component parts or the entire program be abandoned?

***Identifying 'pure' efficiency savings<sup>34</sup>***

Efficiency gains are generally calculated in terms of "running costs". Running costs refer to the costs of administering a department and are used to distinguish efficiency savings from program reductions. A department's running cost expenditure is likely to contain the following main components (Burnell-Nugent 1996):

1. Civil Service pay, travel and subsistence, training, etc.
2. Current expenditure on accommodation - rent, rates, utilities (e.g. water and electricity) and maintenance.
3. Office services, including stationery, postage, telecommunications, computer maintenance, etc.
4. Comparable contracted out services (net of refundable VAT on qualifying service contracts).

Running costs generally exclude all capital expenditure.

It is common to assign an efficiency target to newly merged ministries. Some countries are now setting an annual target for running cost reductions in all budget-funded entities. Obviously, if efficiency savings are to be found then the first choice

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<sup>34</sup> This section draws significantly from (Dorotinsky 2000).

option is to reduce the total spent on running costs. This will include savings on staff as these represent a large proportion of running costs. However, this will require some nuanced understanding of feasible targets for individual ministries, as the potential savings will vary. This points to the need for functional reviews.

However, often savings are needed urgently and where time does not allow the development of feasible ministry-specific efficiency saving targets, then targeted staff reductions are perhaps the next best option. These are preferable to across-the-board staff cuts and can be directed at non-professional or managerial staff. The former generally involves the assignment of a percentage reduction to administrative functions (support staff, such as secretaries, groundskeepers, maintenance workers, clerks, typists). If too large, this may disrupt support operations, and thus indirectly line operations. Across the board cuts to supervisors and middle managers generally entails the assignment of a percentage reduction to managerial functions. Ideally this is associated with a review of spans of control (number of employees per supervisor), taking into account organizational differences, and eliminating levels of management. Middle management reductions should be part of a considered strategy to change the way services are delivered and organizations managed. Often, middle managers are a repository of institutional memory and technical knowledge of operations that, if lost, will reduce over-all organizational productivity.

However, it can be politically difficult to target staff cuts in this way, and they must be seen to be genuinely across-the-board. In such circumstances, the next best options, if savings are needed in the very short term, are:

- **Hiring freezes**, producing savings by not filling vacancies that occur. As vacancies occur more or less randomly throughout the bureaucracy, these will have varying impacts depending on the type of service being delivered. Savings increase with the length of time the freeze is in place, but so does the potential to undermine service delivery. Some of the negative consequences of hiring freezes can be reduced by allowing selective hiring for key sectors or instituting an override mechanism. For example, one vacancy may be filled for every four separations or the agency head can authorize exceptions.
- **Wage freezes** can generate substantial savings (especially where inflation is high) and do not require extensive planning beforehand. Another variation is to freeze all promotions or job reclassifications or eliminate temporarily all salary bonuses. Savings relate to future pressures rather than the current-year wage bill.
- **Base pay reductions** can also generate significant savings (especially when combined with a future freeze) but this is rarely feasible for legal reasons and because of strong employee and union opposition. The impact on employee morale may outweigh short-term financial savings and this strategy is rarely justifiable.
- **Furloughs** entail giving employees mandatory 'leave without pay' for a certain number of days. Not all personnel systems may allow this. This is a short-term measure and does not result in permanent, structural reductions in the wage bill. Strong union opposition can be expected, but this is generates less opposition than a base pay reduction.

Where legally and constitutionally feasible, then early retirement can generate significant savings.

Across-the-board staff cuts are amongst the simplest 'pure' efficiency savings as they are often viewed as equitable and burden sharing. However, both efficient and inefficient, appropriate and inappropriate government functions suffer equally – which is counterproductive for efficient and appropriate programs, and an unwarranted benefit to other programs. This is the least thoughtful approach to achieving necessary reductions, and will have repercussions for performance and productivity. This may undermine government reforms and sectoral strategies. It is not uncommon for Governments to leave the specifics up to line Ministries, for both expediency and an implicit assumption that any cuts will be in accord with sectoral plans. However, Ministries may propose cuts to sensitive programs, knowing the decision will be reversed.<sup>35</sup> Ministries may themselves choose across-the-board reductions as expediency may preclude in-depth analysis. Cuts to low-level employees are often employed, but this is less effective when the wage bill as opposed to the staffing level is capped.

### ***Classification of functions***

(Bannock Consulting 1999) provides a useful summary of the functions that can be seen within public sector activities and that should be distinguished prior to reviewing organizational form:

1. **Policy functions:** such as strategic planning, legal drafting, development of performance contracts, minimum standards, norms, policy analysis and evaluation, forecasting. These functions tend to be regarded as 'inherently governmental' and requiring specialist skills, and are usually provided by core ministries within central government.
2. **Co-ordination, supervision and performance monitoring functions:** such as coordinating relationships between different bodies, monitoring the performance of subsidiary bodies, facilitating and enabling subsidiary bodies to reach their performance targets. These functions also tend to be regarded as 'inherently governmental' and undertaken by core ministries.
3. **Service delivery functions:** such as the provision of products or services to internal (other public bodies) or external (farmers, foresters, fishermen) customers. Service delivery is often provided outside of central government through contracting arrangements or by subnational government. When undertaken by central government this is normally performed by supervised bodies or executing agencies.
4. **Support functions:** such as financial management, human resources management, information systems, infrastructure, staff training, efficiency review and management audit; and secretarial services. These are increasingly contracted out except when regarded as inherently governmental for security or other reasons.
5. **Regulatory functions:** such as licensing, certification, permissions, accreditation, inspection, compliance, and financial audit. These functions are also often regarded as 'inherently governmental' and provided by statutory commissions and other arms length bodies within central government. It is widely maintained that regulatory functions should be separated from those policy functions that

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<sup>35</sup> This maneuver is known as a 'bleeding stump', designed to make cuts seem politically unacceptable.

## Determining the Structure and Functions of Government : Program and Functional Reviews

determine the regulations, and service delivery functions that provide services to customers.

The axiom 'form follows function' was originally drawn from architecture (Louis 1956) but has now been firmly established as a managerial principle in the public sector. See for example (Audit Commission 1996; State Services Commission 1999). The key message is that it is important to reflect on the policy intentions and work out what government is trying to achieve before considering whether and how government should structure organizations to achieve those purposes.

There is, however, another principle implicit in the literature on this subject: "pragmatism determines practice". Whether or not the public sector should deliver services directly, there is little point in specifying an organizational option that cannot be sustained in practice.

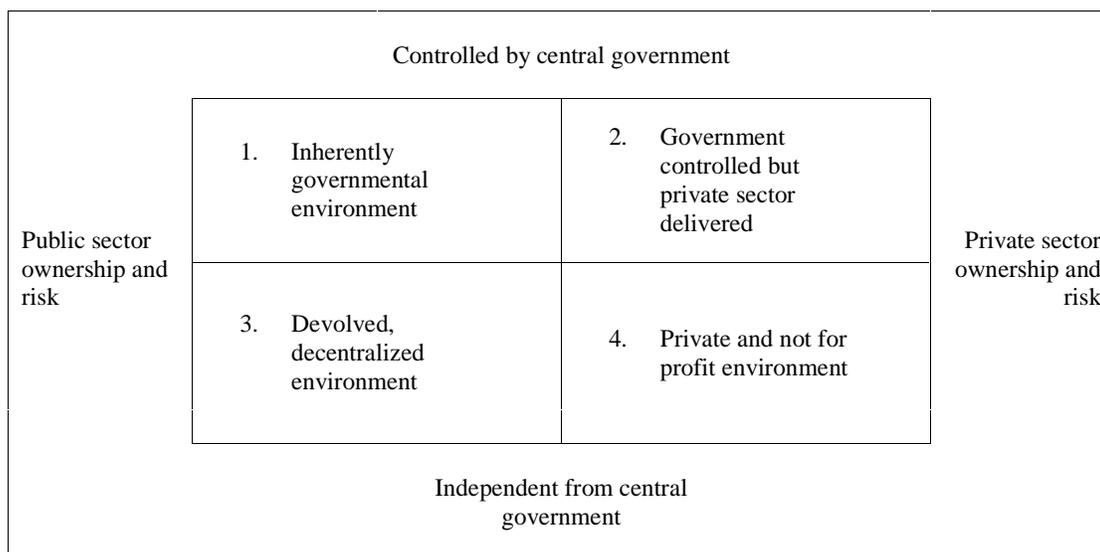
### *Operating environments*

Appendix 2 Figure 1 sets out the four main environments in which governments might expect priority functions to be undertaken. The environments are determined by the degree to which they are controlled or independent from central government, and the degree to which the public sector owns the assets and explicitly assumes the risks of any business failure. The key assumptions are:

1. The choice of how functions are undertaken is not quite as simple as public or private, particularly in a federal setting;
2. Government priorities can be achieved through many mechanisms other than direct service delivery, including regulation, taxation, transfers to subnational government, and subsidies.

The first order question following the analysis of functions is which environment has, or could have, the capability to undertake that function most effectively?

### **Appendix 2 Figure 1 Operating environments**



There is a general assumption in favor of moving functions out of the top left quadrant, unless there are compelling reasons for leaving them there.

Inherently governmental

There is little that is governmental because it can never be contracted out. Boston points out that practically any function can be delivered by the private sector and historically has been at one point or another. Mercenaries have been hired to fight wars and taxes have been collected by private organizations (Boston 1995). The assumptions that define which functions are 'inherently governmental' are of two sorts:

1. Complexity and political sensitivity - some functions are too intricate and sensitive to be contracted out.
2. Pragmatism – although a market *could* be created to undertake the function, this has not happened.

In defining functions that are 'inherently governmental', Boston highlights the risks of contracting out of policy advice to Ministers, pointing out that advisers on strictly commercial contracts are unlikely to be willing to go beyond the basic minimum terms of the contract, will not readily respond to changes in ministers, and will be difficult to monitor (Boston 1995). As Kettl notes: "It is one thing to hire outside concerns to supply goods and services. It is quite another to hire outside concerns to judge what the government ought to buy, how much it ought to pay, and how good the goods and services actually are. The more the government has contracted out its core functions, the more the government worsens its problem of building capacity" (Kettl 1993, p. 19). See also (Rhodes 1994).

More generally, the US Office of Management and Budget (OMB) suggest that an "inherently Governmental function" is one "that is so intimately related to the public interest as to mandate performance by Government employees." (Office of Management and Budget 1999, p. 2). These functions are defined as those that require either "the exercise of discretion in applying Government authority or the use of value judgment in making decisions for the Government."

OMB suggest that inherently Governmental functions normally fall into two categories:

1. Those that relate to the *act of governing* - the discretionary exercise of Government authority:
  - a) Criminal investigations, prosecutions and other judicial functions;
  - b) Management of Government programs requiring value judgments such as direction of the national defense, management and direction of the Armed Services;
  - c) Activities performed exclusively by military personnel who are subject to deployment in a combat, combat support or combat service support role;
  - d) Conduct of foreign relations;
  - e) Selection of program priorities;
  - f) Regulation of the use of space, oceans, navigable rivers and other natural resources;
  - g) Direction of intelligence and counter-intelligence operations;

- h) Regulation of industry and commerce, including food and drugs.
- 2. Others that relate to *monetary transactions and entitlements*:
  - i) Tax collection and revenue disbursements;
  - j) Control of the Treasury accounts and money supply;
  - k) Administration of public trusts.

'Inherently governmental' functions are usually justified by reference to the complexity of the tasks, with fast-changing policies requiring more nuanced interpretations than can be achieved through contracts. In such circumstances, there is generally no effective market to purchase from as the services are not easily specified or priced. Arguably, central government also provides an environment in which staff knows that their jobs are relatively secure and develop a loyalty to the government of the day. This is particularly important when budget funding might be unpredictable, as this tends to reduce public officials' overall performance (Manning, Mukherjee and Gokcekus 2000).

In summary, functions are reported to be 'inherently governmental' when policy is complex and prone to sudden reversals, when there is no realistic market (non-contestable, non-specifiable services), when service failure would be critical, when even-handed regulation required, and when "forgiveness" is required for unpredictable funding.

#### Devolved, decentralized

Strong arguments are made for the decentralization of key services, particularly education, health care, some infrastructure, provision of social safety nets, irrigation, water supply and sanitation, and natural resource management and environment. The arguments are nuanced but the claimed benefits include that decisions about public expenditure that are taken by a level of government closer, and more responsive, to a local constituency are more likely to reflect the demand for local services than similar decisions taken by a remote central government. A related benefit is that people are more willing to pay for services which they find to be responsive to their priorities, especially if they have been involved in the decision making process with regard to delivering the services (World Bank 2001b).

The principle of subsidiarity carries a strong normative value. See for example (European Parliament Directorate-General for Research 2001).

#### Private and not for profit

The key assumption is that this is the first choice environment for undertaking necessary functions. See for example (Role of the State in World Bank 2001d). There is also some reasonable evidence that privatization offers significant benefits. 21 recent empirical studies are cited in (Shirley and Walsh 2000) and these generally find that most firms do better and all firms at least as well after privatization. None of the studies find that performance would be better had they not been privatized.

There are three key questions in considering this environment:

- 4. Is there a market for these functions or services – or could one be created?

5. Can government tolerate the risk of closure?
6. Will any contingent liability be created or exacerbated?

The existence of a market for the services, or the possibility of creating a market, is generally regarded as more probable when policies are reasonably stable, when there is a prospect of raising revenue from fees and charges. The latter applies when the services are specifiable and contestable. See for example (Girishankar 1998).

The World Bank emphasizes privatization of state-owned enterprises following long experience with failed attempts at their reform. Few governments have been able to introduce—and keep in place—the large number of complex and demanding measures needed for effective public enterprise reforms. The Bank notes that whatever the theory, practice suggests that often inefficient but privileged public enterprises drained budgets, diverted resources from health and education, seriously damaged the health of the banking sector, and created obstacles for the development of the private sector (World Bank 2001c).

In principle, this environment is suitable only when government can tolerate the risk of closure or service failure as it has relatively few options for preventing closure. However, the literature on fiscal risk emphasizes that for central governments arms-length arrangements and privatization do not remove the potential contingent liability if explicit or implicit guarantees are offered. See (Polackova 1999a). Appendix 2 Figure 2 sets out the principal risks identified by Polackova,

**Appendix 2 Figure 2 Sources of fiscal risk**

	<b>Direct liabilities</b> <i>Predictable obligations that will arise in any event</i>	<b>Contingent liabilities</b> <i>Obligations triggered by a discrete but uncertain event</i>
<p><b>Explicit liabilities</b> <i>Specific government obligations defined by law or contract - the government is legally mandated to settle such an obligation when it becomes due</i></p>	<ul style="list-style-type: none"> <li>• Foreign and domestic sovereign debt</li> <li>• Budget expenditures—both in the current year and those legally binding over the long term (civil servant salaries and pensions)</li> </ul>	<ul style="list-style-type: none"> <li>• Guarantees for borrowing and obligations of fiscal subnational governments and public or private entities (development banks)</li> <li>• Umbrella guarantees for various loans (mortgage loans, student loans, agriculture loans, small business loans)</li> <li>• Guarantees for trade and exchange rate risks</li> <li>• Guarantees for private investments</li> <li>• State insurance schemes (deposit insurance, private pension funds, crop insurance, flood insurance, war-risk insurance)</li> </ul>
<p><b>Implicit liabilities</b> <i>A moral obligation or expected burden for the government, not in the legal sense, but based on public expectations and political pressures</i></p>	<ul style="list-style-type: none"> <li>• Future public pensions if not required by law</li> <li>• Social security schemes if not required by law</li> <li>• Future health care financing if not required by law</li> <li>• Future recurrent cost of public investments</li> </ul>	<ul style="list-style-type: none"> <li>• Defaults of subnational governments and public or private entities on non-guaranteed debt and other obligations</li> <li>• Liability clean-up in entities being privatized</li> <li>• Bank failures (support beyond state insurance)</li> <li>• Failures of non-guaranteed pension funds, or other social security funds</li> <li>• Default of central bank on its obligations (foreign exchange contracts, currency defense)</li> <li>• Collapses due to sudden capital outflows</li> <li>• Environmental recovery, disaster relief, military financing</li> </ul>

*Note:* These liabilities refer to fiscal authorities, not the central bank.

Source: (Polackova 1999b)

**Government controlled but private sector delivered**

If government must continue to subsidize the function because citizens or businesses could not realistically pay full costs, or if the function is significant and government could not tolerate the risk that the market might cease to undertake the function in the future, then contracting out to the private or not-for-profit sectors is assumed to be preferable.

(Siegel 1999) provides an overview of recent research findings in the successes and limitations of external contracting. The general conclusions are that the most promising targets are those services with clear objectives for the provision of tangible services that can be measured and monitored. Contracting has apparently been less effective in human services and property assessment. In process terms, contracting is generally less successful following sole-source contracting.

Others present a more cautious view. They argue that contracting is more costly than initially apparent and that there are particular problems in contract specification (especially for complex services), and that the cost and difficulty of monitoring contract performance often cause governments to bring previously privatized work back in house. (Ballard and Warner 2000) argue that restructuring through improved labor-management cooperation can provide better quality service with fewer risks and greater social rewards. See also (Ballard and Warner 1999)

### ***Structuring the inherently governmental environment***

#### **Separating policy from implementation**

Efficiency and effectiveness reviews might note that particular functions belong in principle to a particular environment. They can also proceed to suggesting how those environments can be best structured.

In structuring these four environments, the question of whether policy and implementation should be together or separate is perhaps one of the most persistent in recent discussions of public sector reform. Experience tells us that policy-making *can* frequently be separated from implementation with significant results. However, it is dogma that insists that it *must* be. John Stewart makes the point that “(t)he separation of policy-making and implementation will not prove the elixir that will resolve many of the problems of public management... It should be seen as one approach rather than the approach.” (Stewart 1996)

The reasons for considering separation of policy-making from implementation can broadly be characterized as responses to concern about focus or capture. The focus argument is generally made by politicians and public managers, the capture argument by economists and academics.

The focus argument is that service providers should concentrate on efficient production of quality services, with the distractions of evaluating alternative policies removed. In OECD reforms, the discussion of the creation of ‘executive agencies’ in the UK and the similar developments in Australia, Canada, France, Iceland, New Zealand, and Norway has been replete with references to clear, defined targets which allow providers to concentrate on their core business. Similarly, policy-making is seen to be more focused, more rigorous and sometimes even more adventurous if it can be made without the undertow of concern for the existing service providers. The focus argument, put simply, is that policy-making and service delivery are distinct tasks and that each benefits from the additional attention it receives if it is not competing for management time with the other.

The capture argument has a significant academic pedigree. Niskanen and Dunleavy have probably had the most lasting impact on public management (Dunleavy 1991; Niskanen 1971, 1973). Pollitt et al provide a particularly useful overview of these theories (Pollitt, Birchall and Putnam 1998).

The diverse species of collective action/rational choice theory assume, at root, that individuals are largely self-interested and seek to maximize net benefits (personal benefits minus personal costs) to themselves. Niskanen's proposition that public servants are budget-maximisers was a particularly powerful statement of the case. (Niskanen 1971) Because public servants can form an alliance with politicians in which budget growth is seen as a victory for both, because they can hide the costs and benefits of the services that they produce, and because they generally face no competition, then "(a)ll bureaux are too large. For given demand and cost conditions both the budget and the output of the bureau may be up to twice that of a competitive industry facing the same conditions." (Niskanen 1973). Dunleavy has subsequently developed this argument most famously in his bureau-shaping model. (Dunleavy 1991) He argues that senior officials are really interested in maximizing just the direct running costs of the agency and the funds available for contracting suppliers, and have less interest in maximizing the program budget encompassing resources passed on to other bodies for them to spend. In this way he argues that it might be in the interests of these officials to relinquish direct management of some activities as this releases them from responsibilities while allowing them to continue to increase the budgets that matter to them personally.

In either case, the argument is clear. Officials, it is alleged, use their monopoly of information on the costs and consequences of service provision to protect their own interests rather than to provide better services. Niskanen's conclusion is that service delivery should always be separated from policy-making as this is the only route to breaking up the self-serving bureaucracy. Dunleavy's conclusion is more subtle. He cautions that even when this separation is being made, the motives could still be self-interest on the part of the senior officials who see more glory and less hard work in a policy advice role, freed of operational responsibilities. The thesis in both cases is that public bodies are particularly prone to capture by the officials that work there, and that distinguishing between what the agency should do (policy) and how it will do it (implementation) is a key strategy for reducing this risk.

Focus and capture arguments have contributed significantly to the now common practice of decoupling policy-making from service delivery. Both arguments rest on assumptions that do not always hold, and so the logic of the separation must be considered in each case. The focus argument for the split assumes that policy-making is a distinct activity that can be undertaken in isolation from implementation. At best, this is a very partial representation of reality. Frequently, policy is made, or at least significantly adapted, during implementation. The capture argument presupposes that separation of policy making and implementation tasks will reduce the risk that policy is being made to justify the preferences of favored groups - in this case the existing providers. However, in reality the choice might be between the devil and the deep - capture by providers might be providing some defense against a more pernicious capture by others. Since there is no quick way to check the quality of policy other than wait to see what implementation brings, this time lag can allow the policy

providers to advocate policies that suit their ideological or business interests. Providers will still be around when the policy consequences become clear, others might not be. Boston suggests that this may be one reason why, even at the height of managerialist passions in New Zealand during the early 1990's, policy advice was contracted out less in practice than might have been expected. (Boston 1995).

Where policy has been detached from service provision but retained within the public sector, then the New Zealand experience is that the risks of capture may have diminished, but the risks of 'ivory-tower' policy-making may have increased. On balance, and despite rhetoric to the contrary, there is no hard evidence available that 'single-roof' agencies (multi-purpose bodies retaining both policy and service delivery responsibilities) perform less well or are less readily held to account than their single-purpose counterparts. (Boston 1996)

On balance, the conditions when separation of policy-making from implementation is a promising device for improving operational efficiency are as follows (developed from (Stewart 1996):

1. When policy can be specified in advance of action, issues of policy are not raised by the process of implementation and policy-makers do not require advice from implementors
2. When policy can be specified in sufficient detail to cover all eventualities for a given period of time
3. When policy can be specified in terms that allow monitoring of implementation.

Vehicle licensing or refuse collection may meet these criteria, but as Kettl has argued, the production of nuclear weapons does not (Kettl 1993).

### Choosing organizational form<sup>36</sup>

The choices are whether 'inherently governmental' functions should be located in:

- a core ministry; or
- statutory commission or independent regulator; or
- supervised body or executing agency; or
- state-owned enterprise or trading body.

**Core ministries**<sup>37</sup> are best at managing sensitive policy areas when there is no realistic market and there is need for a margin of safety against service failure or a requirement to "forgive" unpredictable funding. Generally, ministries provide policy advice, analysis and evaluation. There is an implicit assumption that ministries are best suited to:

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<sup>36</sup> This draws from (Government of Manitoba 2000; World Bank 2001e).

<sup>37</sup> Ministries are in a legal or constitutional sense indistinguishable from the state. They often have no specific legislative basis and their assets are the general property of the state. Their functions and objectives are multi-purpose, complex tasks, traditionally defined by legislation (Continental European traditions) or determined incrementally by Cabinet (UK and other Anglophone traditions). Their source of funding is almost entirely the state budget and they usually have nil or very minor revenue earnings. As they have no corporate or legal identity separate from the state, they have generally no legal competence to enter into corporate contractual relationships with suppliers.

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- Manage sensitive and volatile policy areas prone to sudden political reversals;
- Deliver services in which there is no realistic market (non-contestable) and which are hard to specify
- Providing a margin of safety against service failure for very politically sensitive services – this includes the ability of core ministries to "forgive" unpredictable funding for operational activities, as secure civil service employment makes staff more prepared to judge government behavior over the longer term.

Ministries may exhibit bureaucratic tendencies, including command and control, hierarchy, uniformity, and conformance to rules and process, however the operational efficiency losses are considered a price worth paying for the margin of safety that they provide in delivering sensitive policy areas. Some challenges and opportunities facing Ministries can be resolved within the current structure by modifying operations to perform in a more business-like way.

**Supervised bodies or executing agencies**<sup>38</sup> are suited for policy areas that are prone to rapid adjustments and where there is no realistic market. These bodies and agencies deliver services where the public sector has a comparative advantage, but need to be placed in a clear accountability framework to a particular Ministry. They tend to be the vehicle of choice for:

- Policy areas prone to adjustment but not dramatic reversals – for example foreign affairs responsibilities are rarely located in an agency, while social security often is
- Delivering services in which there is no market (non-contestable) but where the output required is relatively specifiable.

### **Appendix 2 Box 1 Canadian Special Operating Agencies**

Canadian Special Operating Agencies are a particular example of supervised bodies or executing agencies. SOAs exist along an organizational continuum between a government department and a state-owned corporation. Candidates can be direct public services, internal services to government, science and technology services, or regulatory and enforcement programs. Government delegates service delivery to a designated agency operating at arm's length from mainstream government. The agency remains accountable for results to governing bodies and may have an advisory board comprised of key stakeholders to provide guidance on strategic management. SOAs are distinguished from conventional departmental structures by: a clear mandate confirmed with stakeholders and made public in an operating charter; the requirement to examine becoming an optional rather than mandatory service provider; an accrual basis of accounting, usually applied outside the government's consolidated fund; access to financing and investing supported by a multi-year business plan; full costing and pricing of services, with a view toward financial self-sufficiency; and flexible staffing and continuity in labor relations.

**Statutory commissions and independent regulators** are best suited for functions that fall within a stable policy environment and for regulatory services. Agencies are "statutory commissions" when that they have a well-defined separate legislative

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<sup>38</sup> Executing agencies reporting to Ministries (or reporting to Ministers but under the day-to-day supervision of a Ministry) are often indistinguishable from the state in the legal or constitutional sense. However, the relevant Minister generally defines their objectives (perhaps in a framework agreement) and their source of funding can include some revenue earnings. Executing agencies also rarely have legal competence to enter into contractual relationships with suppliers.

existence. Their objectives are often enshrined in a charter, and their functions are defined by legislation in addition to any powers of direction held by the Minister. They may also be non-asset owning (legally distinct but unable to own assets) or asset owning. They can be budget dependent (subvented) or collect significant revenue earnings. They can also have legal competence to enter into contractual relationships. Such bodies tend to be established for regulatory purposes, although in some presidential systems they can also be service providers.

Statutory commissions provide arms length arrangements when checks and balances are required.

**Trading bodies** can provide functions when the policy environment is stable and there is scope for raising revenue from fees and charges. Trading bodies also have a separate legislative existence. If established under commercial law, then articles of association define their charter and functions. They can be budget dependent, subsidized, or enjoy significant revenue earnings. Trading bodies generally have full legal competence to enter into contractual relationships – they can assume corporate liability and can be sued. Trading bodies provide services that can be operated following private sector models.

Utilities for producing, transmitting, delivering, and furnishing water, electricity, gas, or steam heat; conveying persons or goods; and collecting and disposing of sewage, solid waste, and refuse are the most common examples. A utility is often a monopoly but is expected to apply business-like practices and consider market forces, incentives, and mechanisms to improve service delivery, reduce costs, and protect the public interest. User fees are commonly used to promote fairness, equity, and good management by shifting some or all program costs away from taxpayers to those who derive a direct benefit. While powers can be extended to manage assets, maintain separate accounts, collect charges, and enter into contracts and partnerships, the authority to fix rates and expand services continues to reside with governing bodies, including other orders of government. (Wright 1998) provides details.

There are sufficient cautionary lessons from experience in the management of state-owned enterprises to argue that they should only be used as transitional arrangements for candidates for privatization. Experience suggests that although a nationalized sector has, in principle, the advantage of easier coordination and the ability to fine-tune business practices to achieve social goals, in practice information asymmetries between the government and the firm and the difficulty in enforcing contracts leads to significant inefficiencies (Schmidt 1996; Shapiro and Willig 1990). In particular, public enterprises tend to operate with the security that the government will not allow them to go bankrupt and tend to offer them relatively soft budget constraints. Also, they tend to overinvest, because they can exert political power (Galal, Jones, Tandon and Vogelsang 1994).

Appendix 2 Box 2 Crown Corporations

**Canadian Crown Corporations** are a special case of trading bodies. These are separate legal entities created by federal or provincial statute, generally with the intent of conducting revenue-producing, commercial activities for the public good. Crown corporation status represents the greatest degree of autonomy possible within the public sector. A Crown Corporation is normally a sizable agency that sets its own administrative policy, is financially self-sufficient, and has separate employer status. A

board of directors, appointed in whole or part by government, is responsible for overall management and decision-making for the corporation. A Minister responsible answers in public and interprets the nature of the arm's-length relationship, consistent with legislation and the public interest.

### ***Change processes for moving responsibility outside of central government***

#### Devolving and decentralizing

(World Bank 2001b) provides details of the political, fiscal and administrative elements entailed in decentralization to subnational governments. Devolution or decentralization can be more than simple transfer of responsibility and funds. Partnerships can be established as **intergovernmental agreements** in which organizations at different levels of government contract with each other to deliver public programs or services. This collaborative arrangement is based on mutual interest and a clear understanding of objectives and terms. The partnership can be achieved through either shared services or devolution. **Shared services** involve a joint service agreement where two or more jurisdictions act together to plan, finance, and deliver a public service. **Devolution** involves an intergovernmental service accord where responsibilities are transferred between jurisdictions in return for payment for services delivered. See (Government of Manitoba 2000).

#### Private and not for profit

**Privatization** is a process aimed at shifting functions, in whole or part, from government to the private sector when there is no continuing public policy reason to retain responsibility within government. **Divestiture** is a form of privatization involving the outright sale of government-owned assets or enterprises. After divestiture, government generally has no role in the financial support, management, regulation, or oversight of the divested activity. Consumers, through their buying choices, determine the ultimate viability of the company and the resulting profits allocated to shareholders. In selected cases, government may sell its assets or controlling interest in a service to a private company but protect the public interest through regulation. This is called **regulated** privatization. See (Government of Manitoba 2000).

There are two key areas of market design:

3. Ensuring appropriate regulation; and
4. Enforcing sound corporate governance.

In ensuring appropriate regulation the challenge is that of dealing with potential monopoly practices, and determining when privatization without regulation can be achieved (when conditions for contestable markets exist); when regulated privatization is necessary; and when concession or franchising (allowing one private firm to operate as a regulated monopoly for a limited amount of time) is appropriate.

Corporate governance refers to the maintenance of "balance between economic and social goals and between individual and communal goals" (Dyck 2000; World Bank 2001a).

**Employee Take Over** can be a useful device for privatization. This is an agreement between government and an employee group to have services formerly performed within government provided by the employees as private owners/operators. Prior to the employees resigning from public service to form an ETO company, a contract, lease, or license is negotiated with the government. The take-over group may be required to prepare a competitive proposal alongside private vendors to deliver services. Some organizations offer employees equity through profit sharing to recognize performance, while others sell or lease the operation outright to employees. Considerations in take-over bids include: comparison of cost-benefits with other options; status of the business as a new operation or going concern; valuation and ownership of assets; protection of the public interest through a government equity position; modification of conflict of interest, post-employment codes, and early departure/retirement incentives; union successor rights; and government assistance to employees in developing proposals. An ETO encourages employees to show entrepreneurship and can result in transfer of jobs to the private sector rather than simply job losses.

'Government controlled but private sector delivered'

**Service provision under contract** from private providers can be through **contracting out** arrangements to procure goods or services used in delivering government programs from external organizations, usually the private sector. Government transfers the supply or operation of a function to a contractor for a specified period of time without relinquishing program responsibility and accountability. It remains the financier, has management and policy control over the type and quality of goods or services to be provided, and can replace contractors that do not perform up to the standards and service requirements of the contract negotiated. **Franchising** is a form of contracting whereby government confers the right or privilege to a private concern to conduct a business or sell a product or service in a specific geographic area according to prescribed terms and conditions. Franchises can be either exclusive (i.e., one producer) or inclusive (i.e., many producers), depending on the government's interest in leveraging the marketplace. **Licensing** is another variation through which government grants a license to a private concern to sell a product or service that would not otherwise be allowed outside the public domain. Under either scenario, consumers choose and pay directly for services, contractors pay government a franchise or license fee, and compliance with public purposes and regulations is enforced. Contracting works best for services commonly performed by private companies where outputs can be measured, complexity and contract monitoring are minimal, services can be unbundled, and user fees are charged.

Contracts can be with a **private, not-for-profit agency** - a formal agency volunteer program or a private non-profit service organization in which volunteers provide all or part of a service, either independently or under government direction. Government delegates responsibility to these organizations and provides grants or transfer payments. Other sources of funding are also accessed to deliver the service or perform a self-regulatory function.

**Public/Private Partnerships** are cooperative or joint ventures between two or more parties in the public and private sectors, built on the strength and expertise of each partner, where public needs are agreed upon upfront and are met through the

appropriate allocation of resources, risks, and rewards. The contractual arrangement negotiated involves the private sector in the development, financing, ownership, and operation of a public facility, infrastructure, or service. Financial and human resources are pooled and responsibilities divided so that the partners' efforts complement each other. The partners typically share any income or losses in direct proportion to their investment. Such ventures differ from conventional service contracting in that the private partner usually makes substantial cash, at-risk, equity investment and government gains access to new revenue or service delivery capacity without having to pay the partner. Leasing and buy-out options can be used to facilitate public and private participation. Ultimately, an elected official or body is accountable to the public for decisions and results, while responsibility for achieving planned objectives is shared by the government and partners.

(Thomas 1998) provides further details.

### **Appendix 2 Box 3 Government Owned/Contractor Operated**

**Government Owned/Contractor Operated (GOCO)** arrangements are a special case of such public/private partnerships. These are organizational and commercial arrangements where a government-owned facility is operated by a third party, usually a for-profit contractor. It is used when a government purpose-built facility managed by the private sector remains consistent with the public interest; when a government-owned facility has surplus capacity that a commercial operator can market to the private sector; when technology needs to be transferred to the private sector using private expertise; and as a transitional vehicle for a prospective operator who initially cannot afford to purchase the facility. Government's expectation is that access to private management expertise will increase efficiency, business volumes, and leasing or royalty revenues while lowering unit costs. The contractual relationship negotiated provides for adequate control and intervention mechanisms to protect government interests; structures exchanges of information, requests for service, performance criteria, and evaluations to reflect full costs, profit, and accountability; and transfers and manages assets consistent with government's long-term interests.

### ***Managerial arrangements within public sector organizations***<sup>39</sup>

Following the proposal to transfer functions, the final stage is to review the internal structure of the ministry, statutory commission, supervised body, trading body and to determine whether there is a need for restructuring. This requires determining whether services should be located in a common department, whether departments or divisions need restructuring, and whether managerial responsibilities are balanced and sustainable.

1. Functions of the same type should be grouped together whenever possible to produce economies of scale and maximize synergies and common types of skills;
2. Support functions that enable the core functions of the organization to be performed should be separated from all other functions;
3. There should be equal responsibility for senior staff, either in terms of volume of workload or national importance of the function;
4. There should be clear and short reporting lines;
5. There should be viable sizes of divisions and departments (five or more experts to a division), three to five divisions in a department;

<sup>39</sup> This draws extensively from (Bannock Consulting 1999).

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6. Different organizational units should perform different types of functions (policy, regulation etc);
7. Structures should take into account local history, culture and circumstances;
8. There should be optimum spans of command for managers;
9. There should be equitable workloads;

Structures should be compatible with international and local Law, and where there are conflicts these should be highlighted and options explored for amending legislation.

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