



# **Value for Money in Government Public Administration after “New Public Management”**





Value for Money in Government

# **Public Administration after “New Public Management”**



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## *Foreword*

At the request of the Dutch government, the OECD Secretariat conducted a study on the organisation of central government from the perspective of value for money. The Dutch government is interested in a comparative analysis, both quantitative and qualitative. The OECD Secretariat was asked to focus the quantitative analysis on public employment and the qualitative analysis on the sharing of support services and selected themes in the area of financial management. The following countries were invited to provide information to the study: Australia, Canada, Denmark, Finland, Ireland, New Zealand, Sweden and the United Kingdom. This book contains the result of that study. It is the first volume in the series *Value for Money in Government*.

The study was carried out by a team of the Directorate for Public Governance and Territorial Development consisting of: Ian Hawkesworth, Oscar Huerta Melchor, Dirk Kraan and Camila Vammalle. The team was led by Dirk Kraan. Daniel Sanchez Serra provided statistical assistance.

In order to carry out this study, the OECD team participated in missions to The Hague (the Netherlands), Copenhagen (Denmark) and Stockholm (Sweden) and in each of these capitals met with many officials of the ministries responsible for the organisation of central government. The team wishes to express its sincere gratitude to all of these officials for their efforts to provide the team with the sought after information and for their patience in explaining the often widely diverging structures of their national governments. In particular the team wishes to thank: Mr. Peter van der Gaast, Principal Administrator of the Directorate of Labour Affairs Public Sector of the Ministry of the Interior and Kingdom Relations, who organised the mission to The Hague; Mr. Mogens Pedersen, Deputy Permanent Secretary of the Ministry of Finance, who organised the mission to Copenhagen; and Ms. Lena Westin, Director of the Division for State Administration of the Ministry of Finance, who organised the mission to Stockholm.

In order to collect information concerning the other countries (Australia, Canada, Finland, Ireland, New Zealand, and the United Kingdom), the OECD Secretariat organised a workshop on 3 December 2008 in Paris. The team wishes to thank the officials and members of Permanent Delegations to the OECD who participated in this workshop and for the information they provided in their presentations and documents.

In addition, the team wishes to thank the officials in ministries and statistical offices who completed the quantitative questionnaire (the “snapshot of the public administration”). The team is fully aware that completing this questionnaire was not an easy task, and is grateful that all participating countries made efforts to complete it.

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## Executive Summary

The aim of this study is to compare the organisation of central government in selected OECD countries from the perspective of value for money. The countries covered in this study are: Australia, Canada, Denmark, Finland, Ireland, the Netherlands, New Zealand, Sweden, and the United Kingdom. These countries have been at the forefront of public governance reform in the past. Moreover, the countries are diverse in geographical circumstances and national resources, which have given rise to a wide variety of public policies and governance structures.

The book is divided into two parts: the first contains the results of a quantitative analysis of the number of employees in general government; the second contains qualitative assessments of the development of shared service centres, the steering and control of agencies, spending reviews, and automatic productivity cuts. The book concludes with a list of questions that emerge from the qualitative assessments. These questions could serve as a point of departure for a more extended study on the organisation of central government that the OECD will undertake over the next two years.

### Quantitative analysis

General government employment and central government employment are relatively small in the Netherlands both in terms of the population being served and as a share of domestic employment. Of the sample countries (apart from Australia for which no data are available), the three Nordic countries have the largest general government employment, followed by the United Kingdom, Canada and Ireland. Only New Zealand has a smaller general government employment than the Netherlands.

This general picture may be affected by different organisational arrangements in the health and education sectors. Excluding health and education, general government employment decreases drastically in all countries under review: in the Nordic countries because a large part of public education and public health is provided by local government; in the United Kingdom because public primary and secondary education are

removed from the local government numbers and because the National Health Service (NHS) is removed from the central government numbers; and in the Netherlands because primary and secondary education are removed from the local government numbers and the universities and establishments for tertiary vocational training are removed from the central government figures. The Nordic countries still have the largest remaining general government followed by the Netherlands and the United Kingdom. However, the Netherlands now has the largest central government employment, followed by the Nordic countries and the United Kingdom. (Note that separate data for health and education are not available for Australia, Canada, Ireland, and New Zealand.)

The large share of central government employment in the Netherlands (excluding health and education) is largely due to the high level of centralisation in the Netherlands: 42% of Dutch general government employment is in central government, compared to 39% in the United Kingdom, 28% in Sweden, 23% in Denmark and 20% in Finland.

Differences in outsourcing are another important factor that may explain differences in central government employment. The importance of this factor can be assessed by looking at intermediate consumption (purchase of goods and services from the private sector) and compensation of employment as shares of current operational expenditure. However, the Netherlands has a close to average rate of intermediate consumption (52% of current operational expenditure excluding health and education) so that the reason for the large central government is not a result of low outsourcing.

The last explanatory factor of central government employment addressed in this report is country-specific spending priorities. Spending on labour-intensive policy areas may lead to larger employment than on capital-intensive areas. This factor, together with the large centralisation rate, explains the relatively large central government employment in the Netherlands excluding health and education. However, this analysis cannot distinguish spending priorities from inefficiencies. Thus the relative large labour-intensive spending in the Netherlands on service regulation (largely administrative expenditures of ministries providing individual services: education, health, social services, market subsidies, etc.) may be partly caused by inefficiencies.

Administrative employment, which excludes all actual service delivery both in individual services and in collective services, is another relevant concept for efficiency analysis. According to the snapshots (see Annex B), the Netherlands has larger administrative employment in central government than Australia and Denmark, at least for core ministries and arm's-length agencies (for independent agencies no data are available for Australia or

Denmark). On the other hand, Finland, Ireland and Sweden have larger administrative employment in central government than the Netherlands.

The study also provides information about the organisation of central government between core ministries and agencies. Agencies are further subdivided between arm's-length and independent agencies. The data show that the Netherlands has the largest core ministries, closely followed by Australia. Almost all of central government employment in Sweden is in agencies, which is not surprising in light of the agency tradition in Sweden. Independent agencies are important in the Netherlands, to a lesser extent in Finland, and virtually absent in Sweden.

## Qualitative assessments

### *Shared service centres*

Before 1990, support services, such as human resources, internal audit, procurement, and accommodation and facilities, were more concentrated. For instance, Denmark and the Netherlands had central procurement offices. But after New Zealand and the United Kingdom put into practice the precepts of “New Public Management” in the 1990s, central control was gradually loosened. However, in the last few years some governments realised that the results were not as intended as staff levels had increased in all task areas, and especially in the area of support services. In addition, there were many problems with output steering and control. This led to another change of direction and to a more pragmatic approach involving the re-concentration of central ministerial support services, *ad hoc* downsizing operations, and shared services.

Establishing or rebuilding shared service centres can only be done with the co-operative effort of the top managers of ministries concerned. Usually these efforts are inspired by the political necessity to deliver efficiency gains. However, the success of these initiatives is crucially dependent on the willingness of the co-operating ministries and agencies to transfer tasks to these centres. In the countries under study, three different approaches were followed: one, exemplified by Denmark, relies on a top-down approach in which support service personnel are transferred to shared services centres and ministerial budgets are simultaneously decreased for the corresponding amount of resources. The second, exemplified by Finland and the Netherlands, relies on an incentive, which consists of a specified, temporary cut back target for support services. The third, exemplified by Sweden and the United Kingdom, relies on a different incentive: a temporary or permanent productivity cut, which is not specifically for support services.

For efficiency and savings, the attribution of responsibility for organisational policy and standard setting with respect to support services is an important factor. In Denmark and Sweden these responsibilities are mostly concentrated in the Ministry of Finance. This makes it possible to follow a top-down approach in which support service personnel and budgets are transferred from line ministries to shared services centres. This has already been done in Denmark but not yet in Sweden. In the Netherlands these responsibilities are divided between the Ministry of the Interior and Kingdom Relations and the Ministry of Finance, which would make such an approach hard to achieve. The Netherlands is thus more or less obliged to rely on cut backs to achieve task and personnel transfer and efficiency gains. The Dutch downsizing operation is an incentive, but it is too early to judge whether this is enough. Although the operation may achieve its financial objectives (as did former downsizing operations), it is not clear whether it will achieve its aims of transferring task and personnel to shared services units and reducing support service personnel. The savings from sharing support services that have been realised so far in Denmark, Finland, the Netherlands and the United Kingdom may be modest in relation to total current operational expenditures of central government, but they are substantial in relation to the total costs of support services (which vary between 5% and 20% of current operational expenditures).

### *Steering and control of agencies*

In Sweden there are approximately 250 agencies with a large degree of autonomy and a few fully independent agencies. There are general decrees for all agencies, a specific ordinance for each separate agency and the annual appropriation with performance directions for each separate agency. In Denmark there are approximately 2 000 independent agencies and some 50 arm's-length agencies, the latter under full ministerial responsibility. Independent agencies are governed by some 20 sectoral laws and 50 departmental orders. Both independent agencies and arm's-length agencies must conclude performance agreements in connection with the annual budget process. In the Netherlands there are approximately 700 independent agencies and 40 arm's-length agencies. Independent agencies are governed by a range of sectoral laws, government and ministerial decrees. In addition, each independent agency must have a separate basic law. Arm's-length agencies are based on statutes contained in ministerial decrees, and must conclude performance agreements in connection with the budget process.

The procedures for the steering and control of agencies have been influenced by New Public Management. However, steering and control on the basis of outputs has not always led to the efficiency gains that were expected. On a practical level, staff numbers in agencies increased. In some

countries, including the Netherlands, there were even indications that programme resources had leaked into administrative budgets.

On a more conceptual level, many governments struggled with the implementation of output steering and control because outputs are difficult to measure and politicians are more interested in outcomes than outputs. In spite of far-reaching New Public Management reforms, the practical and conceptual difficulties encountered have led to a certain re-orientation concerning the steering and control of agencies, including:

- more emphasis on careful definition of outputs;
- less emphasis on the annual budget process as a tool for the steering and control of outputs to be replaced by more emphasis on permanent performance dialogue;
- more transparency on input use by agencies;
- the elimination of price versus output distinctions in budget negotiations and in ownership versus client roles of core ministries.

In Denmark and Sweden the initiative for defining outputs has been delegated to the agencies. This precludes that agencies be responsible for outcomes and it assures that the heterogeneity of services is sufficiently recognised. Ultimately, the output definitions have to be agreed by both the agencies and the responsible ministers. However, it may be expected that data manipulation and gaming, which is inherent to every arrangement of output steering and control, will be more manageable if the agencies are committed to the output definitions.

In several countries there has been a tendency to disconnect steering and control of output from the annual budget process. The annual exercise to reach agreement on output targets in the context of the budget process is increasingly seen as ineffective and bureaucratic, partly because output targets are not relevant for funding, and partly because there are better ways for steering and controlling outputs. Sweden has developed procedures that mostly by-pass the budget process, such as an annual performance dialogue with the minister on the basis of the annual agency report, an annual meeting with the National Audit Office on the basis of the audit report, and various forms of evaluation. Denmark and the Netherlands are also putting more emphasis on periodic agency evaluations. In addition, Sweden intends to reduce the annual agency direction attached to the appropriation by formulating informational requirements on performance in the Agency Ordinance.

New Public Management changed the nature of budget negotiations between the minister and line managers. Traditionally these negotiations focused on inputs but have now shifted to the cost of the services. However, it has become clear that this shift is largely one of appearance because in the absence of market prices, costs can only be assessed on the basis of underlying assumptions about the input mix and the input costs. In order to conduct negotiations with agencies in an effective way, agency costs have to be entirely transparent and the minister has to be assisted by advisors that have thorough knowledge of the agency's internal organisation and production methods.

New Public Management described the interaction between the agency manager and the minister by the so-called purchaser-provider model, where the agency manager decides on price and the minister on output. Since the agency is ultimately owned by the ministry, the top management of the ministry not only has the responsibility to advise the minister on output, but also the responsibility to maintain the agency's autonomy in regards to price-setting. In practice this may mean that the top management of the ministry has to protect the agency against too much interference in its internal affairs. However, this model is ill-conceived. As the minister decides both the price and output, the budget process is the best occasion to decide the price, and the performance dialogue the best tool for steering and controlling output.

In practice there appears to be a large difference in the way that independent agencies are steered and controlled on the one hand and arm's-length agencies on the other hand, especially in Denmark and the Netherlands. In general, there are no legal impediments against a more assertive role of core ministries towards independent agencies and basic laws of independent agencies generally recognise the rights of the minister to demand information and to decide on outputs and costs. In the Netherlands there seems to be an historic tradition of *laissez-faire* towards independent agencies, which is hard to change. There also seems to be a widespread feeling that firmer steering and control requires new legislation, which in general is not the case since existing legislation provides a sufficient basis for a more assertive role of core ministries. A first and important step would be to provide more extensive information about the outputs and budgets of independent agencies in the regular budget laws, as for with arm's-length agencies. A second step would be for each line ministry to announce a programme of evaluations of all its agencies (possibly including arm's-length agencies). Such concrete steps could contribute to the transparency of agency operations and could enhance parliamentary interest and oversight.



### *Spending reviews*

Some of the countries of the present study use special forms of policy evaluation in the context of the budget process under names such as “strategic policy reviews” (Australia), “strategic programme reviews” (Canada), “interdepartmental policy reviews” (the Netherlands), and “spending reviews” (the United Kingdom). These procedures are seen as a tool to support priority-setting. Unlike policy evaluations conducted by line ministries, spending reviews not only look at the effectiveness and efficiency of programmes under current funding levels but also at the consequences for outputs and outcomes of alternative funding levels; the Ministry of Finance holds final responsibility for the spending review procedure and the follow up of spending reviews is decided in the budget process. In addition to the Ministry of Finance having final responsibility for the reviews, these procedures have the following characteristics in common: assessments are produced by units that are not under the control of line ministries, the terms of reference for the assessments are not established by the line ministries, and external experts are involved in the reviews.

Spending reviews are seen by the countries that use them as a better way than more traditional tools to find resources to finance new priorities, such as across the board cuts. On the other hand it is generally recognised that to be effective, spending reviews need permanent attention and support from the Minister of Finance and the Prime Minister. A firm legal framework for spending reviews, stressing the responsibilities of the central ministries, may help to provide such support.

### *Automatic productivity cuts*

Productivity gains in the public sector are very difficult, if not impossible, to measure. However, if productivity increases in the public sector, however measured or determined, are recognised, there is room for cutting the inputs of the public sector by the rate of increase in productivity, without changing the level of output. The sample countries that apply automatic productivity cuts are: Australia, Denmark, Finland, New Zealand and Sweden. Usually the cuts (also called “efficiency dividends”) take the form of across-the-board reductions in operational expenses. In some cases, a different rate is applied for different ministries (as for example in Finland). The cut rate is set politically, and ranges from 1-2%.

Those that do not utilise these automatic cuts emphasise that productivity gains differ between policy areas, and if a single productivity estimate is used for the entire government sector or for central government, sectors with relatively low productivity growth suffer. Moreover, they claim

that productivity growth percentage cannot be determined objectively. And since public sector productivity may grow less rapidly than private sector productivity, comparisons between public and private sector productivity in comparable areas are difficult and do not provide reliable results. However, the first risk can be mitigated by flexible reallocation rules that allow ministers to move resources within their portfolios in accordance with productivity developments. The second risk can be mitigated by the choice of a low productivity gain percentage. In the long run this can still lead to substantial savings.

### **Questions emerging from the qualitative assessments**

This study focuses on a limited number of qualitative issues: shared services and some topics in the sphere of financial management. The Dutch government has requested a follow-up comparative review in which the organisation of central government will be studied more broadly. Issues such as policy development and regulatory/supervisory tasks could then be addressed as well. In addition, a follow up study could extend the analysis of the issues of the present study. In particular, it could focus on a number of questions that emerge from the results of the analysis thus far, such as:

- What would be the advantages and disadvantages of a “Danish” top-down approach to the further development of shared services centres? Would such an approach make it possible to dispense with *ad hoc* downsizing operations for support services? Is it necessary for such an approach for the finance ministry to take responsibility for organisational policy concerning support services or is such an approach also possible if organisational policy is located in another ministry?
- Is it possible to define an optimal situation for service sharing? Which services should be shared on which scale? Should shared services also include other levels of government?
- What are the advantages and disadvantages of concentrating shared service centres in one or a few ministries?
- Is it possible to define an optimal regime of administrative autonomy for agency managers that on the one hand stimulates managerial creativity and innovation and on the other hand safeguards operational efficiency?
- Is it necessary to increase the flexibility of human resource allocation within and between agencies?

- Should the regimes of administrative autonomy of agency managers be differentiated from the services the agencies are providing, or from the risks involved in their operations?
- What would an optimal regime of output steering based on the concept of relational contracting look like? Who in the core ministry should be responsible for the steering of agencies and how should the steering process be organised?
- What requirements should be formulated for the cost transparency of agencies?
- Can spending review procedures be institutionalised? Under what conditions?
- What would an optimal regime of automatic productivity cuts look like? Is it possible to design a regime of automatic productivity cuts that does not damage government tasks where productivity growth is slow or absent? Would such a regime make it possible to dispense with *ad hoc* downsizing?



## *Introduction*

In July 2008 the Dutch Ministry of the Interior and Kingdom Relations asked the OECD to conduct a comparative study on the organisation of central government. The Dutch government had launched a reform initiative aimed at “better public service with fewer staff” as part of the coalition programme of the Cabinet that entered into office in 2007. The Dutch government felt that there was still ample room for efficiency improvement and a reason to “hold up existing work to the light and see whether it is still necessary”. A memorandum outlining the programme (Policy Document on Central Government Reform) was sent to Parliament on 25 September 2007.

The Dutch programme is being carried out during the present Cabinet period (2007-11) and should improve the functioning of the central government, including the core ministries, the ministerial agencies (*agentschappen*), as well as the independent agencies (*Zelfstandige Bestuurs-Organen*, ZBOs). The study should cover all tasks of the central government: policy development including planning and advice, support functions (human resources and organisation, information and ICT, accommodation and facilities, communication, finance, audit and procurement), policy execution, and regulatory and supervisory services. The programme is designed to reduce the size of the public service by 11 000 employees (full-time equivalents) and yield EUR 630 million savings in 2010. In order to avoid achieving the financial target but failing the personnel target, as happened with downsizing operations in the past, the financial and personnel targets will be separately monitored in the present programme. Agencies that are financed by user fees will also be subjected to a personnel reduction target, although this does not yield budgetary proceeds (it will be reflected in lower fees). This target has been set upon 1 785 full-time equivalents in 2010.

As part of the programme, the Dutch government wants to monitor developments in public employment and organisational structures in other OECD member countries. It was for this purpose that the Ministry of the Interior and Kingdom Relations asked the OECD in July 2008 to: *i*) conduct a limited, mostly quantitative study on employment in the general government sector; *ii*) present a limited number of qualitative assessments

on the structure of central government and its standard operating procedures; and *iii*) organise an international conference to discuss the results of this study. The qualitative assessments would have to focus on the themes of shared support services and the planning and control cycle. In addition, the Ministry asked the OECD to explore the feasibility of a more extensive international study, to be conducted in co-operation with a limited number of broadly comparable countries that would address in general the organisation of central government from the perspective of improved quality of services and more efficiency in central government.

This book contains the results of the initial study which provided the basis for an international conference that took place in June 2009 in Paris.

The book is divided into two chapters. Chapter 1 contains the results of the quantitative study. Chapter 2 presents the qualitative assessment on a limited number of themes.

## *Reference*

Minister of the Interior and Kingdom Relations of the Netherlands (2007), *Policy Document on Central Government Reform*, Ministry of the Interior and Kingdom Relations, The Hague, [www.minbzk.nl/english](http://www.minbzk.nl/english).

## *Chapter 1*

# **Quantitative Comparison of Public Service Employment**

*This chapter presents the results of a quantitative analysis of the number of employees in general government using three different data sources (the OECD Public Finance and Employment Database, the ILO LABORSTA database, and the snapshots of the public administration). This chapter also addresses administrative employment – which excludes all actual service delivery both in individual services and in collective services – as a relevant concept for efficiency analysis. The extent to which countries delegate tasks to agencies differs between countries. There is also a discussion of the distribution of central government employment over the four types of government tasks: policy development, policy execution, support services, and regulatory/supervisory services.*

## Employment in central government

The Dutch government is interested in an international comparison of public service employment in the following eight countries: Australia, Canada, Denmark, Finland, Ireland, New Zealand, Sweden, and the United Kingdom. These countries are thought to be broadly comparable to the Netherlands and have been at the forefront of public governance reform in the past.

It should be recognised that in spite of similarities, the differences between the central governments in the sample countries are vast. They are the result of long historical developments. In addition, the countries are diverse in geographical circumstances and national resources, which have given rise to a wide variety of public policies and governance structures.

Against this background a central consideration for any attempt to compare public employment in these countries has to be which factors should be excluded from the comparison (“controlled for”) in order to arrive at conclusions that policy makers can use in their efforts to improve the quality of public services and the efficiency of government. It should be clear at the outset that not all relevant variables can be controlled for because the data which would allow such control are lacking and because this would lead to endless discussions about the relevance and specification of every relevant factor. Under these conditions, the most sensible way to proceed is to identify the most obvious relevant factors and to acknowledge from the outset that the results of the comparison, after controlling for those factors, can never be more than rough indications about remaining interesting differences. There may be perfectly good explanations for these differences. That a country employs more staff in the police, basic research, social services or infrastructure than another country may be due to a variety of good reasons, apart from possible inefficiencies in organisation or policy design. Even the most important reason, namely that a country may seek to attain a higher quality of services, cannot be controlled for because that would require internationally comparable indicators for output quality, which in most policy areas are not available or, in the few policy areas where international efforts have been made to collect them (mostly in health and education), beset by innumerable complications.

While emphasising these limitations, the result of a quantitative comparison that controls for the most obvious factors is still worthwhile. Each country included in the comparison can learn how it differs from other countries and it may provide a basis for qualitative inquiry into the reasons for the difference. This further inquiry could look at the governance



structures in the countries concerned and attempt to explain the quantitative differences. This may subsequently lead to indications about relative quality of services and efficiency. An initial step towards such a more qualitative analysis is provided in Chapter 2.

The factors that the present study has taken into account while comparing central government employment are the following:

- part-time employment;
- the total size of the population to be served by the central government;
- the total domestic workforce available for economic production, including the production of public services;
- the degree to which public service provision has been attributed to the (private) corporate sector outside government (including non-profit institutions in the corporate sector);
- the degree of centralisation or the division of employment over central and local government;
- the degree to which intermediate production has been outsourced to the (private) corporate sector outside government;
- the distribution of spending over the policy areas.

The way in which each of these factors is taken into account will now be explained.

Countries differ in the degree to which they utilise part-time public employees. In order to control for this factor, all employment numbers are converted into full-time equivalents. Since numbers in full-time equivalents are not available for some of the countries included in the sample, the public employment numbers for these countries have been computed by assuming that the number of working hours per employee in the domestic economy also applies to the government sector.

The size of the population is evidently an important determinant of public employment. This is not to say that the relation should be proportional. On the one hand there are economies of scale in service provision, and on the other hand not all public employment is in service provision. Indeed, a substantial amount of public employment, particularly in policy development, support services and regulatory/supervisory services, is not necessarily related to the population being served. Moreover, service provision not only relates to individual services (social services, education, health, etc.) but also to collective services (armed forces, police, prisons,

etc.) for which the relation to the population being served is not straightforward. In order to take account of the population being served, all employment numbers will be provided per thousand inhabitants.

The size of the domestic workforce is also an important factor, since the public sector has to compete with the private sector on the labour market. If labour is scarce and expensive, efficient production is less labour intensive. In order to account for the domestic workforce, all employment numbers will be provided as well in percentage of domestic employment (since unemployment is volatile, domestic employment will be used as proxy for the domestic workforce).

The degree of decentralisation has to be taken into account as well. Since this factor too is very different between the countries in the sample, a comparison of only central government employment would lead to a misleading picture. For this reason, public employment numbers will be provided for central government as well as for general government. General government includes the central government sector, the social security sector, the state sector in federal governments (which is relevant to Australia and Canada), and the local government sector (municipalities, counties, etc.). The employment numbers for the social security sector are added to those for central government for reasons to be mentioned in the next section on data sources.

Some countries in the sample have attributed large parts of publicly financed service provision to the (private) corporate sector, but others have not. This is true for instance for the health sector. In the Netherlands, health services are provided entirely by the corporate sector (mostly non-profit institutions classified in the corporate sector such as hospitals and doctors), whereas in the Nordic countries they are mostly provided by the general government sector (particularly in local government). Similarly, in most countries a substantial part of education is provided by the corporate sector whereas in the Netherlands it is almost entirely provided by the general government sector (particularly by local government, except universities and institutions for tertiary vocational education, which are in central government)<sup>1</sup>. Since this factor primarily affects the comparison in the policy areas of health and education, employment numbers will be provided including and excluding health and education. It should be mentioned though that this procedure does not entirely solve the problem, since differences in the attribution of service provision to the corporate sector may occur in other policy areas as well, particularly in social services and in culture, recreation and religion, albeit on a smaller scale. If the purpose of the comparison is to focus attention on differences other than those in the organisation of service provision, this may lead to some error.

The countries in the sample show different patterns of outsourcing of intermediate production to the (private) corporate sector. This factor may also give rise to misleading comparisons. In order to highlight the importance of this factor, the report shows intermediate production as a share of current, operational expenditure per policy area.<sup>2</sup>

Finally, the distribution of spending over policy areas is an important determinant of public employment. A country that spends more on a labour-intensive policy area (say social services) than another country that spends relatively more on a capital-intensive policy area (say infrastructure) is prone to have larger public employment, all other things equal. The report will highlight the relevance of this factor by providing data about the distribution of central government spending over the policy areas with an indication of the labour intensity of each policy area.

## Administrative employment

The report will also pay attention to administrative employment as opposed to service provision. Administrative employment can be defined as all public employment concerned with policy development, administrative policy execution (handling of subsidies, grants, social benefits, tax assessments and other legal decrees in individual cases), regulatory/supervisory services, and support services related to these tasks (not to service provision). As for service provision, administration can have the character of a collective or individual service. In general, the administration of the provision of individual services will have the character of an individual service, whereas the administration of the provision of collective services will have the character of a collective service.<sup>3</sup>

## Data sources

The study makes use of three data sources: *i)* the *Public Finance and Employment Database* (PFED) of the OECD; *ii)* the *LABORSTA database* of the International Labour Organization (ILO); and *iii)* the snapshots of the public administration. The first two are existing international databases; the third one has been established for the purpose of this study.

The PFED is a database that has been developed by the Directorate for Public Governance and Territorial Development of the OECD (OECD, 2009).<sup>4</sup> It contains data about expenditures, revenues, costs of production and employment per policy area for general government and each of its sub-sectors (central government, states, local government, and social security). The PFED is entirely consistent with the international System of National

Accounts (SNA) (United Nations, 1993). The distinction of the policy areas in the PFED are based on the international Classification of Functions of Government (COFOG) (IMF, 2003). However, in contrast to regular COFOG, the PFED distinguishes between collective and individual services and between services in kind and in cash. Services in cash are non-earmarked transfers by which the government performs redistributive policies (social benefits in cash, foreign development aid, non-earmarked transfers to sub-national government, etc.). The resulting classification of policy areas is called “COFOG-Special” (see Annex A) in order to distinguish it from regular COFOG. The PFED is a secondary database in that it is constructed entirely from other international databases and not from questionnaires to national statistical offices. Next to regular COFOG, the PFED uses the OECD National Accounts (for revenue data), EUROSTAT National Accounts (for expenditure data)<sup>5</sup> and LABORSTA (for employment data). Australia, Canada, Ireland and New Zealand are not included in the PFED because the required national accounts data for these countries are not available. For the same reason, only data on central government are available for the Netherlands (not for local government and thus not for general government).<sup>6</sup>

The social security sector in the System of National Accounts (SNA) consists of the institutions that administer the social insurance laws. According to the SNA, a country may lack a social security sector because the national statistical office may choose to consolidate its social security sector with the central government sector in its national accounts. In order to avoid international incomparability of employment data as a consequence of different practices in this respect, all data provided in this report for the central government are in fact data for the merged central government and social security sectors.<sup>7</sup>

The LABORSTA database of the ILO is not only an underlying source of the PFED but has also been used to split general government employment in service provision and administrative employment. For this purpose use has been made of the International Standard Industrial Classification of all Economic Activities (ISIC-Rev3).<sup>8</sup> ISIC data are not available in LABORSTA for Ireland and Sweden. In addition, LABORSTA is used to obtain general and central government employment data for countries that are not included in the PFED (Canada, Ireland and New Zealand)<sup>9</sup> and to obtain general government data for the Netherlands.

The snapshot of the public administration is a classification of employment in central government that has been developed by the Dutch government in the context of the “Central Government Reform” initiative. The snapshot includes all central government employment, except non-profit institutions inside central government, the police<sup>10</sup> and the armed

forces. Excluded as well are employment in the judicial branch (the courts),<sup>11</sup> the Parliament, the Chamber of Accounts and the Royal Household. It classifies employment according to two criteria: *i*) type of government task; and *ii*) type of governmental organisation. With respect to type of government task it distinguishes between:

- policy development (including planning and advice);
- support functions (human resources and organisation, information and ICT, accommodation and facilities, communication, finance, audit and procurement);
- policy execution;
- regulatory/supervisory services.

With respect to type of governmental organisation it distinguishes between:

- core ministries;
- arm's-length agencies;
- independent agencies.

The snapshot has been used as an alternative source to approach administrative employment and moreover to shed light on the organisation of government in terms of types of tasks and organisations.

As part of the present study, a questionnaire was sent out to the sample countries asking them to fill in a snapshot for employment in their central government. In order to further international comparability, the questionnaire used the same guidelines that were used to establish the Dutch snapshot. The questionnaire was completed by six countries (Australia, Denmark, Finland, Ireland, the Netherlands, and Sweden), but was not completed by Canada, New Zealand and the United Kingdom. Ireland only provided data for the core ministries (not for arm's-length agencies and independent agencies). Australia and Denmark only provided data on core ministries and arm's-length agencies (not on independent agencies). In addition, the questionnaire asked to split out the support functions in the categories mentioned above. This was done by Denmark, Finland and the Netherlands (not by Australia, Canada, Ireland, New Zealand, Sweden and the United Kingdom). In general, the countries that replied to the questionnaire had considerable difficulties filling it in. In view of the results, the two largest problems for international comparability arising from the snapshot data are support functions in arm's-length agencies, and individual service provision outside health and education.

According to the Dutch guidelines for the snapshot, the tasks in arm's-length agencies and independent agencies do not need to be split according to tasks. Employment in the entire agency could be assigned to its main task. This could imply that staff in an agency be assigned to support functions only if the majority of staff in that agency worked in support functions. In that case the support staff in the agency would probably support the core ministry or other agencies, but not the agency itself (for instance a shared service unit). In other words, the support staff in agencies serving the agency itself would not be categorised as support staff, but rather in accordance with the main task of the agency (mostly policy execution or regulatory/supervisory services). In other countries, however, support staff in agencies was sometimes identified as such and categorised as support staff. From the perspective of international comparability, this is of course the right procedure because otherwise the identification of support staff becomes dependent on whether it is part of the core ministry, and if not, on whether it is organised in a separate agency or not.

According to the Dutch guidelines, non-profit institutions classified in central government,<sup>12</sup> are not taken into account. This excluded educational establishments (mostly universities and other tertiary education)<sup>13</sup> and all social and cultural non-profit institutions (museums, etc.) classified inside central government. As it turns out, however, as far as the use of non-profit institutions is concerned, there are considerable differences between countries. In order to further comparability, the OECD guidelines for the snapshot excluded all educational establishments and health providers,<sup>14</sup> but this does not entirely solve the problem since there are also service providers outside health and education where the variable use of non-profit institutions may impair comparability (institutions excluded in the Dutch snapshot because they are non-profit, but included in other countries because they are agencies of central government). With hindsight it would have been better for comparative purposes to exclude all individual service provision inside central government, whether in non-profit organisations or not and whether in health or education or in other areas.

Table 1.1 summarises the relevant differences in the content of the databases.

## **Size of central and general government**

General government employment is relatively small in the Netherlands both in terms of the population being served as well as a share of domestic employment. Figure 1.1 shows that the three Nordic countries have the largest general government employment, followed by the Anglo-Saxon countries except New Zealand. General government employment in the

Netherlands is larger than New Zealand. Central government employment in the Netherlands is larger than in Canada (which is a federal country and hence quite decentralised) and smaller than in all other countries. Central government employment in the Anglo-Saxon countries (except Canada) is larger than in the Nordic countries, whereas the opposite is true for general government employment: the Nordic countries have larger government sectors but are more decentralised.

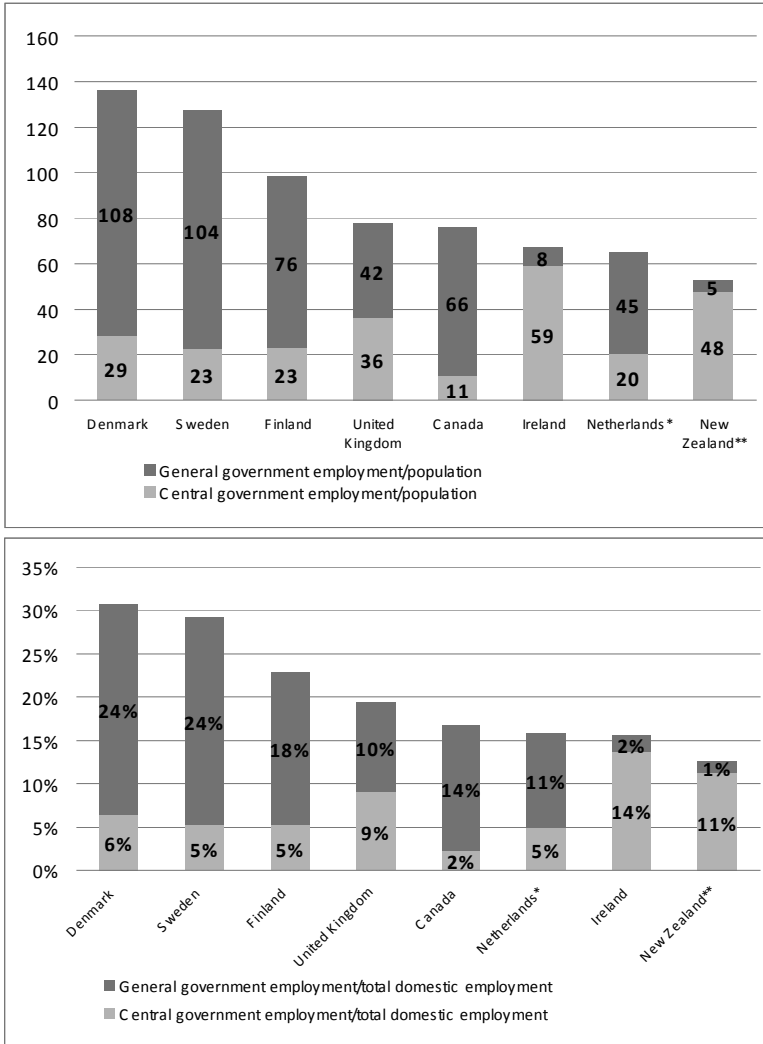
**Table 1.1. Contents of the databases in the area of public employment**

Institutions of central government	Types of employment		LABORSTA ISIC group L <sup>a</sup>	PFED	Snapshots
			Only public employment <sup>b</sup>	General government and sub-sectors	Only central government
Household Head of State Judicial branch Parliament Audit institution	Administrative employment		Included	Included	Excluded
Core ministries	Administrative employment		Included	Included	Included
Arm's-length agencies	Collective service provision	Armed forces	Included	Included	Excluded
		Other (police, prisons, etc.)	Included	Included	Partly excluded <sup>c</sup>
Independent agencies	Individual service provision	Health providers, educational establishments	Excluded	Included	Excluded
		Other (social and cultural services, etc.)	(Mostly) excluded	Included	Included
Non-profit institutions (inside central government)	Individual service provision	Health providers, educational establishments	Excluded	Included	Excluded
		Other (social and cultural services, etc.)	(Mostly) excluded	Included	Excluded

- a. Group L: Public administration and defence; compulsory social security.
- b. The ISIC classification of LABORSTA contains public employment (general government plus public enterprises), but the table indicates only which parts of central government employment are included in these amounts.
- c. The police is excluded (but the National Police Services Agency in the Netherlands is included, see note 9).

**Figure 1.1. Employment in general and central government relative to population and domestic employment**

Full-time equivalents per 1 000 inhabitants (2006) and per cent of domestic employment in full-time equivalents (2006)



\*=2005, \*\*=2004.

Sources: *Public Finance and Employment Database* (OECD) and *LABORSTA* (ILO).

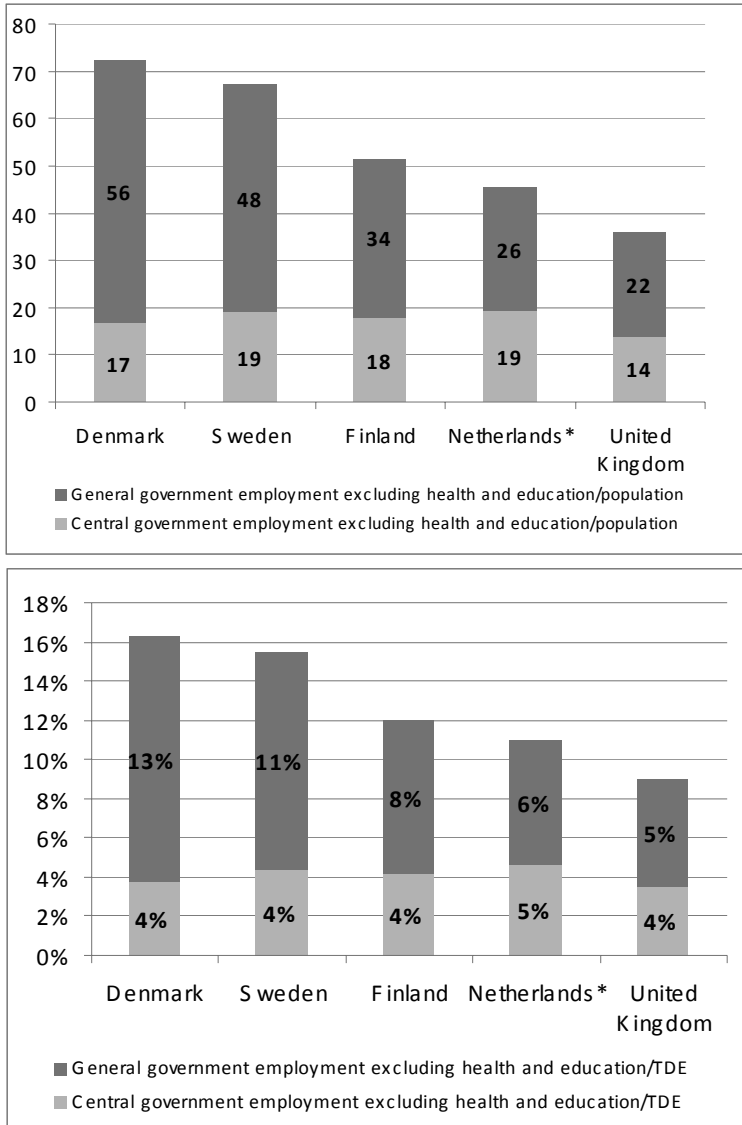


As mentioned above this general picture may be affected by different organisational arrangements in the health and education sectors. Obviously, these differences are mostly real, in the sense that they reflect national policies, sometimes rooted in profound convictions concerning the governance of the institutions in these areas. They do not merely result from different practices of national accounting. In this light, excluding health and education from the comparison should not be interpreted as an “improvement” of the comparative picture. Rather a comparison that leaves out these policy areas must be seen as an informational device that focuses attention on the differences in other policy areas. Moreover, differences in attribution to the private sector also occur in other areas than health and education. With these caveats in mind, it may nevertheless be useful to provide a picture without health and education. Figure 1.2 shows these results. Australia, Canada, Ireland and New Zealand are lacking in these figures because no PFED data on health and education are available for these countries. For the Netherlands, education has been eliminated from general government employment through an approximation (for the Netherlands general government employment is not available for policy areas.<sup>15</sup>

Excluding health and education, general government employment decreases drastically in all countries: in the Nordic countries because a large part of public education and public health is provided by local government; in the United Kingdom because public primary and secondary education are removed from the local government numbers and because the National Health Service (NHS) is removed from the central government numbers; in the Netherlands because primary and secondary education are removed from the local government numbers and universities and establishments for tertiary vocational training are removed from the central government figures. It appears that the Nordic countries still have the largest remaining general government followed by the Netherlands and the United Kingdom. However, the Netherlands now has the largest central government employment, followed by the Nordic countries and the United Kingdom (for Australia, Canada, Ireland and New Zealand no PFED data on health and education are available, so they could not be separated).

**Figure 1.2. Employment in general and central government excluding health and education relative to population and domestic employment**

Full-time equivalents per 1 000 inhabitants (2006) and per cent of domestic employment in full-time equivalents (2006)



\* 2003; TDE = total domestic employment.

Source: *Public Finance and Employment Database* (OECD).

It appears from Figure 1.2 that the Netherlands has the highest central government employment among the sample countries for which data are available when the policy areas of health and education are excluded. However, apart from different practices of outsourcing and different spending patterns which will be addressed below, this picture is strongly affected by different degrees of decentralisation. Table 1.2 shows rates of centralisation, defined as central government employment as a share of general government employment per policy area,<sup>16</sup> excluding health and education. Since no data on policy areas in local government are available for the Netherlands, only the total rate can be provided.

Annex C contains a calculation of central government employment “corrected for decentralisation rate” (on the basis of the assumption that the rate would be equal to the average in all countries).

Table 1.2 shows a very significant discrepancy between the Netherlands on the one hand and the Nordic countries on the other hand. The United Kingdom takes an intermediate position, but is closer to the Netherlands than to the Nordic countries as far as decentralisation is concerned. Lacking Dutch data on local government employment per policy area it is unfortunately not possible to pin down the reason for this discrepancy more specifically.

Differences in outsourcing are another important factor that may explain differences in central government employment. The importance of this factor can be assessed by looking at intermediate consumption (purchase of goods and services from the private sector) and compensation of employment as shares of current operational expenditure. Table 1.3 shows these shares in each policy area (excluding health and education).

It appears from Table 1.3 that outsourcing rates are the lowest in public order and safety, followed by general governance services (tax service, foreign service, etc.), basic research, defence, service regulation, non-market recreation, culture and religion, and social services. Not surprisingly, the outsourcing rates are the highest in infrastructure and network services, and environmental development and community services. The Netherlands outsources relatively a lot in basic research and in defence and relatively little in general governance services and non-market recreation, culture and religion. In view of the moderate average rate of intermediate consumption (52%), the cause of the large central government excluding health and education cannot consist in low outsourcing.

**Table 1.2. Rates of centralisation per policy area excluding health and education**

Full-time equivalents (2006)

		Denmark	Finland	Netherlands*	Sweden	United Kingdom
Collective goods in kind	Central government services	0.35	0.28	n.a.	0.32	0.39
	Basic research	1.00	1.00	n.a.	1.00	1.00
	Defence	0.98	1.00	n.a.	0.99	1.00
	Public order and safety	0.91	0.77	n.a.	0.78	0.25
	Infrastructure and network services	0.20	0.68	n.a.	0.67	0.53
	Environmental, development and community services	0.34	0.30	n.a.	0.06	0.17
	Service regulation	0.16	0.44	n.a.	0.44	0.36
Individual goods in kind	Non-market recreation, culture and religion	0.37	0.05	n.a.	0.14	0.32
	Social services	0.03	0.08	n.a.	0.08	0.21
	Market subsidies	0.00	0.00	n.a.	0.00	0.00
Total central government employment/total general government employment		0.23	0.36	0.42	0.28	0.39

\* 2003.

*Source: Public Finance and Employment Database (OECD).*

**Table 1.3. Rates of intermediate consumption per policy area excluding health and education**

Per cent of current operational expenditure (2006)

	Denmark	Finland	Netherlands	Sweden	United Kingdom	Average
General governance services	44.1	51.7	56.3	47.7	49.9	49.9
Basic research	47.0	31.4	43.1	44.2	86.8	50.5
Defence	54.5	61.9	39.9	66.1	64.2	57.3
Public order and safety	29.3	28.9	41.8	34.3	59.7	38.8
Infrastructure and network services	80.5	81.3	77.1	69.9	79.8	77.7
Environmental, development and community services	61.4	47.4	67.9	75.4	75.0	65.4
Service regulation	53.9	45.2	60.3	71.9	59.3	58.1
Non-market recreation, culture and religion	36.7	51.9	60.4	44.9	73.3	53.4
Social services	47.9	54.2	53.0	39.0	53.5	49.5
Total	47.7	51.1	52.2	54.7	62.3	53.6

*Source: Public Finance and Employment Database (OECD).*

The last explanatory factor of central government employment that is addressed in this report is the country-specific spending priorities. As mentioned above, more spending priorities on labour-intensive policy areas may lead to larger employment than more spending on capital-intensive policy areas. Apart from capital, other kinds of spending may diminish labour intensity as well. For instance, a country may further its policy goals in the area of public order and safety by giving subsidies to the retail sector for improving preventive security measures, rather than by employing more police officers. It should be noted that the factor of spending priorities overlaps with the previously mentioned factors of decentralisation and outsourcing. A policy area may be less labour intensive in country A than in country B, not only because A spends more on capital or subsidies, but also because A spends more on earmarked transfers to local government leading to higher local employment<sup>17</sup> or on intermediate consumption. If country A in addition spends more on this policy area than on other policy areas, then the effect is strengthened, all other things equal.

The importance of spending priorities can be assessed by looking at compensation of employment as share of total expenditure. Table 1.4 shows these shares in each policy area (excluding health and education).

Table 1.4 shows that spending patterns are not widely different between countries. For expenditures on goods in kind<sup>18</sup> the largest share in each country goes to social services, apart from the United Kingdom, where defence is slightly larger. The next three spending categories are public order and safety; infrastructure and network services; and environmental, development and community services. The smallest spending categories are: general governance services, basic research, defence (except in the United Kingdom, where it is among the largest), service regulation and non-market recreation, culture and religion, and market subsidies. The most labour-intensive spending categories are basic research, defence, public order and safety, and service regulation, which, apart from public order and safety (and in the United Kingdom from defence), do not belong to the larger spending categories. However, countries that spend more than average on them, particularly on public order and safety (that does belong to the larger spending categories), may therefore have larger employment. This applies to the Nordic countries (for public order and safety) and the United Kingdom (for defence). Annex C contains a calculation of central government employment corrected for decentralisation rates, outsourcing rates, labour intensity and spending priorities (on the basis of the assumption that these rates as well as spending priorities would all be equal to the average in all countries). After correction the Netherlands again has a smaller central government than the Nordic countries, but somewhat larger than the United Kingdom (due to the large correction for the United Kingdom for labour-intensive defence spending). Spending priorities together with the large centralisation rate mostly explain the relatively large central government employment in the Netherlands excluding health and education. It should be emphasised that this analysis cannot distinguish “spending priorities” from inefficiencies. Particularly, the relative large labour-intensive spending in the Netherlands on service regulation (largely administrative expenditures of ministries providing individual services: education, health, social services, market subsidies, etc.) may be partly caused by inefficiencies.

**Table 1.4. Compensation of employment relative to total expenditure per policy area excluding health and education and total expenditure per policy area relative to total expenditure on services in kind**

Per cent of total expenditure per policy area (2006) and per cent of total expenditure on services in kind (2006)

	Denmark		Finland		Netherlands		Sweden		United Kingdom		Average	
	(1)	(2)	(1)	(2)	(1)	(2)	(1)	(2)	(1)	(2)	(1)	(2)
General government services	50	5	46	7	26	13	41	11	47	7	42	9
Basic research	37	1	62	3	52	5	50	5	6	0	42	3
Defence	43	9	37	11	54	9	29	15	35	23	39	13
Public order and safety	66	5	67	8	25	11	59	10	25	16	48	10
Infrastructure and network services	8	3	7	12	7	11	11	17	5	13	8	11
Environmental, development and community services	22	1	31	2	10	2	9	2	6	8	16	3
Service regulation	43	3	51	7	37	10	27	9	38	5	39	7
Non-market recreation, culture and religion	41	3	6	3	2	2	24	3	19	5	18	3
Social services	2	63	5	40	1	33	19	20	9	21	7	35
Market subsidies	0	8	0	9	0	4	0	8	0	3	0	6
Compensation of employment over total expenditures	14	100	21	100	19	100	26	100	21	100	20	100

1. Compensation of employment over total expenditures.

2. Percentage of total expenditures on goods in kind.

Source: *Public Finance and Employment Database* (OECD).

It is also interesting to look at remuneration levels. Countries may have relatively large government employment but this may be compensated by relatively low remuneration levels. Unfortunately this is a difficult area for international comparisons because of different working hours, benefit packages and average income levels. In the context of the present study, this area could not adequately be explored. However, a very rough measure (compensation of employment divided by employment in FTEs) shows that remuneration in central government is relatively high in the Netherlands compared to the Nordic countries but salaries in the Dutch public sector include premiums for the funded pension scheme. After correction for these premiums, remuneration of Dutch employment in central government would be slightly higher than in the Nordic countries, but not much.

### **Size of administrative employment**

For the analysis of efficiency in government, administrative employment is an important concept. It excludes all actual service provision both in individual services (schools, health providers, etc.) and in collective services (armed forces, road construction, etc.). Group L of the ISIC classification of economic activities (“public administration and defence; compulsory social security”) can be seen as an approximation of this concept.<sup>19</sup> However, this measure is by no means precise mostly because it includes parts of collective service provision such as the military forces and the police. In order to come closer to the concept of administrative employment as defined in this report a number of service provision tasks have been taken out, in particular: *i*) the armed forces; *ii*) justice and judicial activities, which include the penitentiary institutions; *iii*) public security and law and order, which includes the police; *iv*) fire service activities; and *v*) other defence activities.<sup>20</sup> The resulting picture is provided in Table 1.5. Ireland and Sweden are lacking from this table (see section on Data Sources above).

It appears from Table 1.5 that Denmark and Finland, which have larger general government sectors than the Netherlands and the United Kingdom, actually have lower administrative employment (compare to Figure 1.1). This is not only due to large educational and health care provision in general government, also because without these services Denmark and Finland have the largest general government sector (compare to Figure 1.2). Canada on the other hand has a smaller general government sector than Denmark, Finland and the United Kingdom, but larger administrative employment (how far this is due to health and education cannot be established due to the



lack of PFED health and education data for Canada). New Zealand has the smallest general government sector in the sample (with health and education) and also quite small administrative employment. The New Zealand case is what one would expect, the other cases are remarkable. While looking at these data, it should be firmly kept in mind however that ISIC data refer to general government and not to central government (thus include local government).<sup>21</sup>

The snapshots provide an alternative source for the estimation of administrative employment. In contrast to ISIC group L, the snapshots only include central government and social security (not states and local governments), and they exclude the Household of the Head of State, the Parliament, the judicial branch, the Supreme Audit Institution (the High Colleges of State) and the armed forces (military employment as opposed to civil employment in the policy area of defence). Moreover, non-profit institutions inside central government are more systematically excluded than in ISIC group L. The results are provided in Figure 1.3 relative to domestic employment and per capita respectively. For Australia and Denmark the figure shows only employment in core ministries, and for Ireland it only shows employment in the core ministries.

In contrast to ISIC group L, the snapshots only include central government and social security (not states and local governments), but the snapshots may contain errors of unknown magnitude. According to the snapshots, the Netherlands has larger administrative employment in central government than Australia and Denmark at least as far as core ministries and arm's-length agencies are concerned (for independent agencies, data are not available for Australia and Denmark). On the other hand, Finland, Ireland and Sweden have larger administrative employment in central government than the Netherlands. The picture alters a bit the pattern discernible in Figure 1.2. The conclusion is that the relatively large Dutch central government employment shown in Figure 1.2 must be due to institutions of central government excluded from the snapshot (high colleges of state, armed forces, police, and non-profit institutions outside health and education).

**Table 1.5. Administrative employment in general government (including local government) relative to population and domestic employment**

Full-time equivalents \* 1 000 (2006)

	A. ISIC group L (FTEs*1 000)	B. Armed forces <sup>a</sup> (FTEs*1 000)	C = A – B (FTEs*1 000)	C per 1 000 inhabitants (FTEs)	C in % of domestic employment (% FTEs)	D. Justice and judicial activities, public security and law and order activities, fire service activities and other defence activities <sup>2</sup> (FTEs*1 000) <sup>b</sup>	E = C – D (FTEs*1 000)	E per 1 000 inhabitants (FTEs)	E in % of domestic employment (% FTEs)
<b>Australia</b>	341.8	42.3	299.5	14.6	3.6	n.a.	221.2 <sup>c</sup>	10.8	2.7
<b>Canada</b>	747.0	54.6	692.4	21.2	4.7	n.a.	548.7 <sup>d</sup>	16.8	3.7
<b>Denmark</b>	121.8	24.5	97.3	17.9	4.0	19.4	77.9	14	3.2
<b>Finland</b>	102.3	29.7	72.5	13.8	3.2	16.4	56.1	10.7	2.5
<b>Netherlands</b>	461.4	31.4	430.0	26.4	6.5	123.4	306.6	18.8	4.6
<b>New Zealand<sup>e</sup></b>	65.7 (84.4)	7.6	58.1 (76.8)	14.3	3.4 (4.3)	26.3	31.8 (50.5)	7.8	1.9 (2.8)
<b>United Kingdom</b>	1 474.5	119.5	1 355.0	22.4	5.5	491.6	863.5	14	3.5

a. Source: *OECD Labour Force Statistics*.b. ISIC 7523, 7524, 7525 plus the difference between ISIC 7525 and armed forces *OECD Labour Force Statistics*; the data in this column have been provided by National Statistical Offices in reply to a question posed by the Dutch Central Bureau of Statistics. These data are based on national databases and have not been checked by the OECD Secretariat.

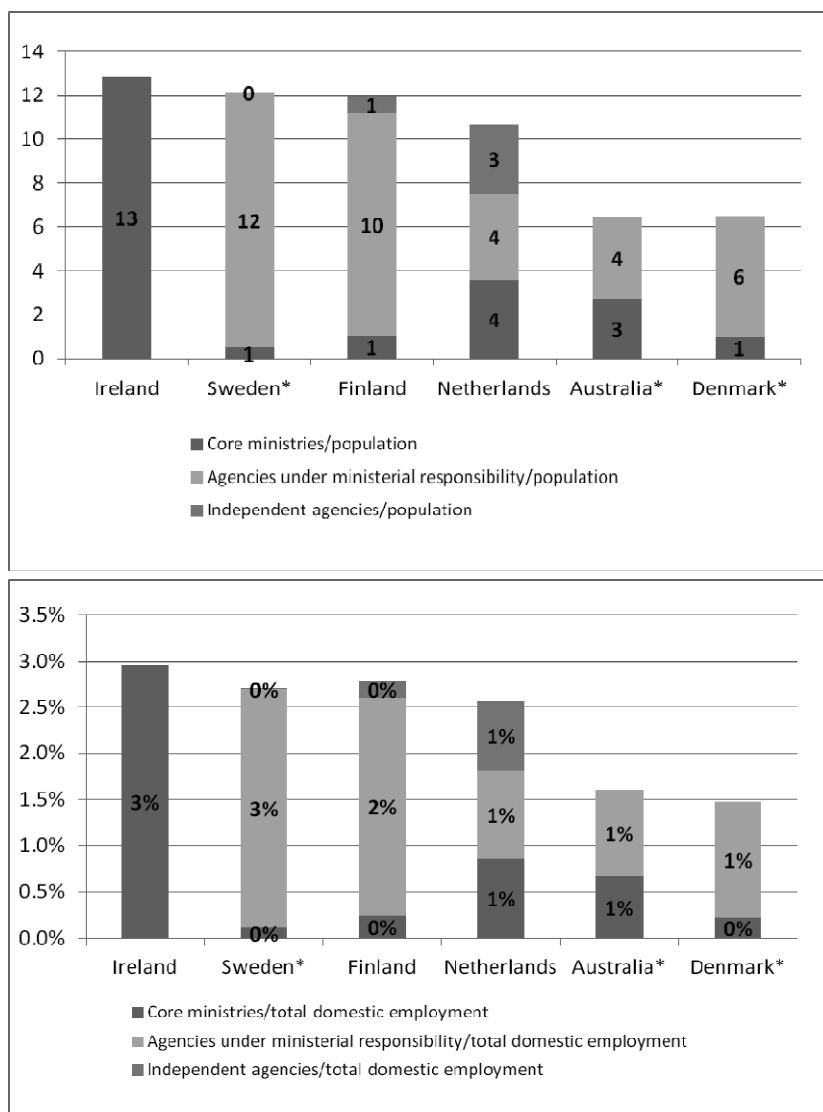
c. Amount provided by the Australian Bureau of Statistics in reply to a question posed by the Dutch Central Bureau of Statistics. This amount has not been checked by the OECD Secretariat.

d. Amount provided by the National Statistical Office of Canada in reply to a question posed by the Dutch Central Bureau of Statistics. This amount has not been checked by the OECD Secretariat.

e. This calculation is based on ISIC group L and Total Domestic Population data for New Zealand from 2004. According to information provided to the Dutch Central Bureau of Statistics the ISIC group L number from 2006 in FTEs is 84.4 (\* 1000). According to *OECD Labour Force Statistics* total domestic employment from 2006 is 2 117 (\*1 000) in persons employed or 1 744 (\* 1 000) in FTEs. Using these data from 2006, C per 1 000 inhabitants is 4.3 FTE and E per 1 000 inhabitants is 2.8% FTE in New Zealand.

**Figure 1.3. Employment in central government without high colleges of state, armed forces, non-profit institutions, health providers and educational establishments relative to domestic employment and the population**

Full-time equivalents per 1 000 inhabitants (2006) and per cent of full-time equivalents (2006)



\* 2008.

Source: snapshots of the public administration.

## Organisation of central government

Apart from information about the size of central government, the snapshots also provide information about the organisation of central government. A distinction has been made between core ministries and agencies. Agencies are defined as units with a separate financial administration and a certain autonomy in operational management. They are financed on the basis of the unit cost prices of their services (“selling their services to the core ministries and the public”) rather than on the basis of their input costs. This provides them with a certain autonomy concerning the organisation of their production process. Agencies are further subdivided in arm’s-length agencies and independent agencies. Arm’s-length agencies are defined as agencies that provide services for which the minister is responsible as far as executive policy is concerned (not necessarily for services in individual cases). The minister also remains responsible for operational management. Independent agencies are defined as agencies providing services for which the minister is not responsible, neither for executive policy, nor for services in individual cases. The minister remains responsible for operational management in independent agencies. Furthermore, in both cases the minister is responsible for the legal framework in which the agencies operate. Usually the withdrawal of independent agencies from ministerial responsibility for executive policy has something to do with required independence *vis-à-vis* the executive branch: regulatory/supervisory authorities, social security authorities (administered by social partners), etc. The countries that filled in the snapshot had considerable difficulties in identifying independent agencies and in particular in differentiating between independent agencies inside government and non-profit institutions inside and outside government (the latter mostly financed by government but not controlled by government).<sup>22</sup>

Table 1.6 shows employment per type of government unit as a percentage of total snapshot employment in central government. In view of the limited availability of data on independent agencies (three out of seven snapshots), the shares of core ministries and arm-length’s agencies have also been expressed as a percentage of their total (core ministries plus arm’s-length agencies). Ireland is excluded because it could not provide data on arm’s-length agencies.

It appears from Table 1.6 that the Netherlands has the largest core ministries, closely followed by Australia. Sweden has almost all of its central government employment in agencies, which is not surprising in light of the agency tradition in Sweden. Denmark and Finland take intermediate positions. Independent agencies are important in the Netherlands and to a

lesser extent in Finland. (The Swedish number is not zero but rounds to zero.)

**Table 1.6. Distribution of central government employment over types of government units**

Per cent of snapshot employment in full-time equivalents (2006)

	Core ministries	Agencies under ministerial responsibility	Total	Core ministries	Agencies under ministerial responsibility	Independent agencies	Total
<b>Australia*</b>	42	58	100				
<b>Denmark*</b>	15	85	100				
<b>Finland</b>	9	91	100	9	85	7	100
<b>Netherlands</b>	48	52	100	33	37	30	100
<b>Sweden*</b>	4	96	100	4	96	0	100

\* 2008

Source: snapshots of the public administration.

The snapshots also provide information about the distribution of central government employment over the four types of government tasks: policy development, policy execution, support services, and regulatory/supervisory services. Table 1.7 shows this distribution as a percentage of total snapshot employment for core ministries and arm's-length agencies (Ireland is again excluded).

Interestingly, Table 1.7 shows relatively low shares of employment in policy development and support services for the Netherlands (the sum being the lowest of all countries). Whereas Denmark has relatively low employment in support services, it has larger employment on policy development. While looking at this picture, it should be kept in mind that the percentages are strongly affected by the organisation of policy execution, which in some countries may largely take place outside the core ministries and the arm's-length agencies in independent agencies, non-profit institutions and local governments. Also, the problems of international comparability of the snapshots mentioned previously (support services in arm's-length agencies and individual service provision outside health and education) are important. With these caveats in mind, the most significant numbers of Table 1.7 are perhaps those for policy development and support services and their mutual relation. In Australia and the Netherlands these

numbers are the same size; in Denmark the numbers for support services are much smaller; and in Finland and Sweden the numbers for support services are much larger. This is an interesting result that deserves more investigation on a country-by-country basis.

**Table 1.7. Distribution of employment in core ministries and arm's-length agencies over types of tasks**

Per cent of snapshot employment in full-time equivalents (2006)

	Policy development	Support services	Policy execution	Regulatory and supervisory services	Total
<b>Australia*</b>	29	32	25	14	100
<b>Denmark*</b>	14	3	69	14	100
<b>Finland</b>	7	16	71	6	100
<b>Netherlands</b>	7	5	83	5	100
<b>Sweden</b>	3	24	73	0	100

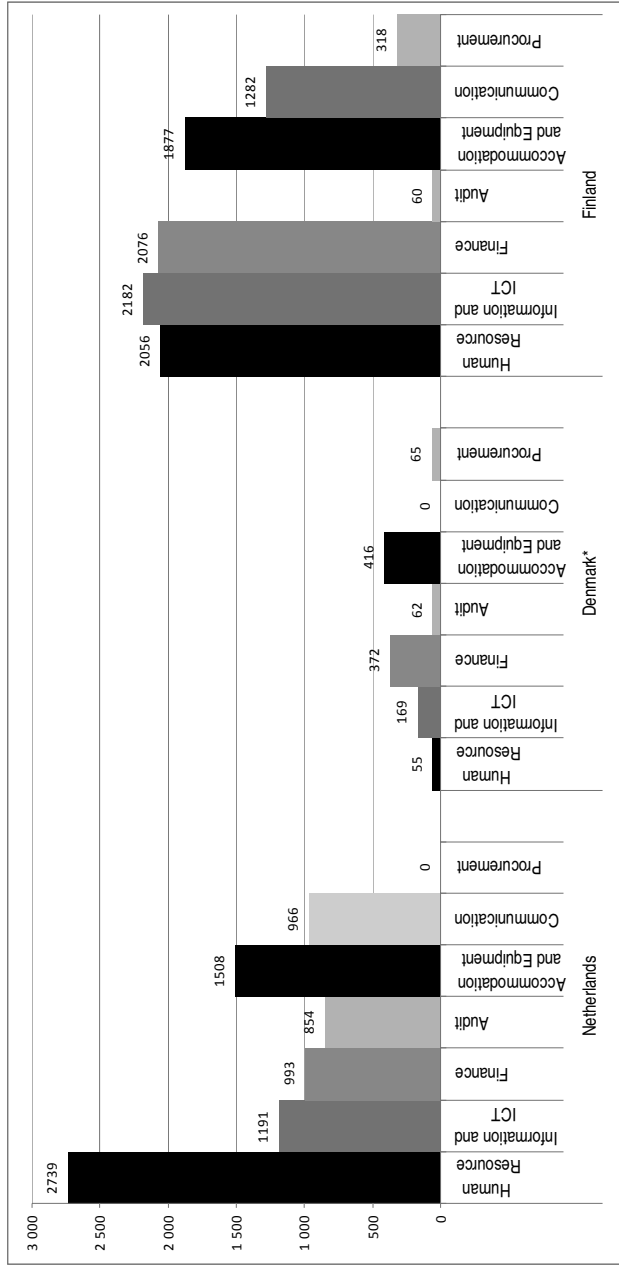
\* 2008.

*Source:* snapshots of the public administration.

Some countries that filled in the snapshot were also able to split out the support services according to type of service. This required, among other things, to split up shared services centres according to their tasks, which was not always easy. Figure 1.4 shows the results for the three countries that could accomplish this task for core ministries and arm's-length agencies.

The picture is in absolute numbers. It shows remarkable differences in the pattern of support services employment. Outliers for the Netherlands are human resources and organisation and audit (a much higher percentage than in other countries). Note that audit here refers to internal audit because the Supreme Audit Institution was not part of the snapshots. Denmark has lower employment in support services in all categories with outliers in finance and accommodation and facilities.<sup>23</sup> Finland has a negative outlier in audit but larger employment in support services in all categories except human resources than all three countries.

**Figure 1.4. Employment in core ministries and arm’s-length agencies in support services over type of service**  
Number of full-time equivalents (2006)



\* 2008.

Source: snapshots of the public administration.

## Notes

1. Although in the Netherlands two-thirds of the publicly funded educational establishments in primary and secondary education are non-profit institutions, they are supposed to be controlled by government and thus classified in the general government sector.
2. Operational expense includes compensation of employment, intermediate consumption and depreciation of capital. Current operational expenditure includes compensation of employment and intermediate consumption (not depreciation of capital).
3. Note, however, that in the PFED (see section on data sources), some administrative tasks related to individual service provision have been assigned the character of a collective service, namely service regulation (COFOG-Special group 7).
4. The PFED was created in 2008 as a combination of the expenditure database COFOG-Special and the *OECD employment database CEPD*. For earlier work on the CEPD see Pilichowski and Turkisch (2008).
5. The PFED uses EUROSTAT expenditure data rather than OECD data because for the construction of COFOG-Special, it is necessary to use second level COFOG data (which split policy areas into sub-areas) which are not available in the *OECD National Accounts*.
6. Australia, Canada and New Zealand are not included in the EUROSTAT database. Furthermore, Ireland has not yet delivered its second-level COFOG data to EUROSTAT, and the Netherlands has only delivered data for central government and social security.
7. To avoid awkward terminology the term “central government” will always be used instead of “central government and social security”.
8. In addition, for one table use has been made of second-level ISIC data that are not available from LABORSTA but only from national



statistical bureaus (Table 1.5). These data have been collected with the help of the Dutch Central Bureau of Statistics.

9. These countries are not included because the PFED is constructed on the basis of second-level COFOG data, which are not available for these countries (see note 6). No employment data could be obtained via LABORSTA for Australia because they do not provide data to LABORSTA.
10. However, in the Dutch snapshot the National Police Services Agency (providing special police services at the national level) is included.
11. In the Dutch snapshot, some 10 000 administrative staff of the courts are included. This became clear only after the snapshots for other countries had been completed. Other countries may have followed different approaches to the exclusion of the courts.
12. According to the SNA, non-profit institutions mostly financed by central government and controlled by central government are to be classified in central government and not in the corporate sector.
13. Primary and secondary education is in the local government sector.
14. In the Dutch snapshot, health providers are not only excluded because they are (mostly) non-profit institutions but also because they are not in the government sector, but this is not the case in the other countries in the sample.
15. In order to eliminate education from general government employment, the public sector ISIC group Education was used as an approximation. This leads to a small overestimation of general government and of the centralisation rate because the COFOG group education does include more than service provision (also administrative employment). Health provision is in the corporate sector in Netherlands and did not need to be subtracted from the general government total. However, here too there is some administrative employment in the COFOG group Health that remains included in the general government total and that leads to some small overestimation of general government and the centralisation rate.
16. Employment per policy area is estimated in the PFED on the basis of compensation of employment expenditures. This assumes equal average salaries in all policy areas per sub-sector of general government. This may lead to some error in absolute employment numbers, but less so in longitudinal and cross-sectional comparisons (salary differences between policy areas are relatively stable over time and similar between countries).

17. Note that local employment is financed on the one hand by own resources of local government (including tax-sharing) and non-earmarked transfers (a COFOG-Special group in cash, thus not included in Tables 1.3 and 1.4) and on the other hand by earmarked transfers.
18. Cash transfer programmes such as foreign development aid and unemployment benefits are excluded because by the definitions of the PFED they do not contain compensation of employment. For the COFOG-Special classification see Annex A.
19. The LABORSTA database provides data on how public employment (general government plus public enterprise) is split up between the economic activities of the ISIC classification.
20. Other defence activities are the difference between ISIC group 7522 (defence activities) and the armed forces according to the *OECD Labour Force Statistics*. This is mainly civilian defence personnel, which has been counted as service provision rather than administration. Only in Denmark and Finland are armed forces (*OECD Labour Force Statistics*) larger than defence activities (ISIC 7522), due to the fact that armed forces includes military personnel recruited by conscription. In this case the difference between ISIC group 7522 and the *OECD Labour Force Statistics* armed forces is negative and leads to a smaller subtraction from ISIC group L (because personnel on conscription is not included in ISIC group L and should not be subtracted).
21. Note that if the centralisation rates of Table 1.2 were applicable to administrative employment in the sense of ISIC group L, the ordering would remain the same. Administrative employment per 1 000 inhabitants for central government would become: Netherlands (11), United Kingdom (9), Denmark (5), Finland (5).
22. Making these distinctions requires information about the institutional classification of the national accounts. This information was not always taken into account by those who filled in the snapshot.
23. Facilities include cleaning, post, reproduction, catering, security, service cars.

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## *Chapter 2*

### **Qualitative Assessments of Recent Reforms**

*This chapter presents qualitative assessments of the development of shared service centres, the steering and control of agencies, spending reviews, and automatic productivity cuts. Before 1990, support services, such as human resources, internal audit, procurement, and accommodation and facilities, were more concentrated. In the 1990s, under the influence of “New Public Management”, central control was gradually loosened. However, in the last few years some governments realised that the results were not as intended, as staff levels had increased in all task areas and especially in the area of support services. In addition, there were problems with output steering and control. This led to another change of direction and to a more pragmatic approach involving the re-concentration of central ministerial support services, ad hoc downsizing operations, and shared services. The chapter concludes with a list of questions that emerge from the qualitative assessments. They can serve as the basis for a follow-up review in which the organisation of central government will be studied more broadly. Issues such as policy development and regulatory/supervisory tasks could then be addressed as well.*

## Focus of the qualitative assessments

This chapter will focus on recent developments in the sample countries in the areas of shared services and selected issues concerning financial management. As far as the latter is concerned the report will pay attention to: *i)* the steering and control of agencies; *ii)* expenditure review; and *iii)* automatic productivity cuts. Chapter 2 concludes with a list of questions that emerge from the qualitative assessments and that may serve as a point of departure for a more extended study on the organisation of central government that the OECD will undertake in the next two years (“Value for Money in Government, Phase II”).

Since the information collected on these themes is much more detailed for the countries that were visited for this study (Denmark, the Netherlands and Sweden) the focus will necessarily be on those countries. However, some information was also collected from other OECD sources and through the workshop on 3 December 2008 in which Finland, Ireland and the United Kingdom also made presentations on these subjects. This leads to a somewhat unbalanced treatment of the various sample countries. In view of the character of this part of the report as an issue paper that mainly aims to provide a first ordering of the relevant developments and to set the stage for a more extensive study, this should not be pose a major problem.

## Shared service centres

### *Definition*

Shared service centres can be defined as government units providing support services to more than a single ministry or sub-sector of government (central government, social security funds, local government). Support services include human resources and organisation, information and ICT, accommodation and facilities, communication, finance, audit and procurement.

Units that provide support services to a single ministry (including its agencies) are not considered as shared service centres. These units have always been the most important providers of support services in central government and still are, in most OECD member countries. On the other hand, units that provide support services to two or more (core) ministries and/or agencies of two or more ministries can be considered as shared service centres. Units of this kind have existed in many OECD member countries for a long time, but have recently become the focus of policy development concerning the organisation of government. A possibility that

goes even further and that has been envisaged in various countries, but still hardly practised, is the establishment of units that serve one or more ministries as well as sub-national governments such as counties or municipalities.

An important distinction needs to be made between the two tasks that have to be fulfilled in relation to support services generally, namely:

1. standard setting;
2. support service delivery.

Standard setting concerns the setting of general rules for the use and management of support services. This includes the general rules for human resources management (recruitment, performance assessment, job and rank classifications, salary scales, career planning, etc.), for the use of office accommodation (square metres per employee, etc.), for procurement, for financial management, for internal audit, etc.

Support service delivery concerns the actual provision of the support services to the client ministerial divisions and agencies.

Standard setting is a policy-making task with respect to the use and management of support services. Support services delivery is an executive task with respect to support services.<sup>1</sup> This distinction of tasks is important in relation to the definition of shared support centres because it clarifies its implications: standard setting units are not themselves shared services centres, even if the scope of the standards is government wide (which it usually is). Only units engaged in actual support service delivery are considered as shared service centres if they serve more than one ministry and/or agency.

A further conceptual distinction concerns ICT as a support service. ICT support can be external or internal:

- **External ICT support** concerns communication between government and citizens/enterprises, including common portals for these communications (*i.e.* e-government).
- **Internal ICT support** concerns data processing within government and communication between government units.

Internal ICT support can be available to any government unit, including other support service units. The ICT systems used are generally owned by, and possibly shared among, the client units, for instance salary payment systems for human resource units or budgeting and accounting systems for finance units.<sup>2</sup> Internal ICT support can be general or task specific:

- **General ICT support** mainly concerns desktop facilities, intranets and help desks.
- **Task-specific ICT support** concerns data processing and communication tailored to the specific tasks of the government units concerned, for instance website design and maintenance, design and maintenance of common portals, development and advice on the development of ICT systems.

Evidently, general ICT support can be shared more easily than task-specific ICT support, (for example the tax service, the police, etc.). However, certain aspects of task-specific ICT can sometimes still be shared (design and maintenance, development, etc.).

### *Historical development*

Various interlocutors from the sample countries have pointed out that in the last decades there has been a swing movement concerning the centralisation of support service delivery in their central governments. Before the 1990s, support services such as human resources, internal audit, procurement, and accommodation and facilities were more centralised. For instance, in Denmark and the Netherlands central procurement offices existed. In the Netherlands, internal audit was concentrated in the Ministry of Finance for all ministries. In Denmark, the Netherlands and Sweden staff numbers by ranks were centrally controlled for all ministries in the Ministry of Finance or the Ministry of the Interior. In the 1990s, central control was gradually loosened under the influence of a school of thinking in public administration known as “New Public Management” (NPM, see Box 2.1). The ideas of New Public Management spread rapidly after they had been put in practice in New Zealand and in the United Kingdom.

In many countries the organisation of support services has been affected by the ideas of New Public Management. In particular, the message “let managers manage” led to additional freedoms of line managers both in core ministries and in agencies. This applied to the use of inputs (outsourcing, staffing levels and remuneration including variable pay), and also to the organisation of support services. Consequently, the position of central ministerial support service units weakened. Often, these units were partly broken up and decentralised over line managers. In addition, the use of these units by agencies was in many cases no longer obligatory but optional. Agency managers could shop around for support services or develop their own support services, supposedly in the light of cost-benefit considerations. Closed shop arrangements were thought to induce unnecessary bureaucratic



costs and deemed to be inefficient. Steering and control was supposed to take place on the basis of outputs, not of inputs.

### **Box 2.1. New Public Management**

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

- Separation of execution from policy development: Execution should take place in agencies that are (at least) on arm's-length distance from the core ministry. Agencies should have their own financial administration, separate from that of the ministries. The financial administration should be based on accruals and give insight on the cost per unit of output. Agencies should be financed on the basis of the purchaser-provider model, in which the agency sells its outputs to the core ministry for a price per unit.
- More autonomy for line managers in operational management, both in policy development and policy execution ("let managers manage"): This implies that government-wide standards for operational management are loosened or abolished. Standards for operational management apply to the use of operational means: human resources and organisation, finance (budgeting and accounting), internal audit, communication, accommodation, real estate and facilities (reproduction, safety, catering, transport, etc.), information and ICT, and procurement.
- Steering and control of executive agencies on the basis of measured output: This requires that each agency defines all its outputs and that quantitative indicators are developed to measure the outputs. Agency budgets have to be based on output targets and costs per unit of output. Retrospectively, agencies are held accountable for the realisation of output targets, and financial sanctions can be applied in case of underperformance.
- Budgeting on the basis of measured output (performance budgeting): Output measurement not only serves as a basis for agency financing but also as a basis of the government budget as such. All ministries have to formulate their targets in terms of outcomes and outputs. The budget classification is based on homogeneous groups of outcomes and outputs. The budget is a policy document that informs the Parliament and the public what the government wants to achieve, what it will do for that purpose, and what its activities will cost. Retrospectively the government is accountable for what it has achieved at what costs.
- Outsourcing of intermediate production to the market: All intermediate production, be it by government agencies or by procurement, is to be subjected to permanent comparison of quality and prices (market testing). If the market comes out on top – which it will often do in view of better incentives – intermediate production should be outsourced and public production should be abolished.

In the last few years, some governments realised that not everything had worked out as intended. It turned out that staff levels had increased in all task areas, and especially in the area of support services. In addition, there were many problems with output steering and control. This led to a certain change of direction and to a more pragmatic approach.

### ***Overview of recent developments***

In the area of support services, three recent developments in particular come to the fore: re-concentration of central ministerial support services, *ad hoc* downsizing operations and sharing support services.

The difficulty of measuring the outputs of policy-making units is straightforward: numbers of laws or policy measures make no sense. It is perhaps for this reason that the managerial authority granted to line managers of policy-making units of core ministries has always been more limited than those of executive agencies, even during the high days of New Public Management. In particular, the de-concentration of ministerial support services to policy-making units has generally been limited. In recent years it has often been reversed.<sup>3</sup> This has led to a certain re-concentration of ministerial support units.

Output measurement of executive agencies is still generally considered as feasible. As a consequence, the authority of agency managers is in many OECD members countries, and in particular in the sample countries of this study, still largely as it emerged from the New Public Management era. However, with two qualifications: *ad hoc* downsizing operations and shared service centres.

*Ad hoc* downsizing operations on inputs (personnel, travel, consultancy, etc.) were a frequently used tool of budgetary policy in the era before New Public Management in most of the sample countries. They have often been successful in the sense that budgetary targets were achieved,<sup>4</sup> but they have often wreaked havoc in the civil service and could almost never be implemented smoothly. On the other hand, downsizing operations have always been popular among politicians and the citizenry. The goal of cutting red tape and waste has figured in electoral platforms of political parties from left to right since the development of the welfare state. It is popular among right-wing politicians who want to reduce taxes and expenditures as a matter of principle, and it is popular among left-wing politicians who want to show that the public administration can be efficient. However, in the era of New Public Management, the political desire for downsizing operations led to increasing tensions with the civil service, that saw the new management approach as a shield against political encroachments upon its domain. For a

time, this led to less frequent use of *ad hoc* downsizing operations on inputs. However, in recent years these operations are back, at least in a number of countries, some of which in the past have gone far in the opposite direction of extending managerial authority: Finland, France, the Netherlands and the United Kingdom.

*Ad hoc* downsizing operations usually focus on administrative budgets. This includes the current operational expenditures of policy-making units, support service units, regulatory/supervisory units and those executive units that carry out administrative tasks (not service delivery; see Table 1.1). In the budgeting process, administrative budgets in this sense have always been kept apart from programme budgets (including budgets for service delivery units). Even in countries where the budget classification was thoroughly revised in the 1990s on the basis of programmes or policy areas (Denmark, France, the Netherlands, Sweden and the United Kingdom), administrative budgets were maintained as separate budget items, in order to avoid programme resources leaking into administration. This makes it relatively easy to focus budget cuts on administrative budgets.

Cuts on administrative budgets are not necessarily incompatible with managerial discretion over input use. In fact, they leave the managerial authority over staffing levels, pay levels, outsourcing and organisation of support units entirely intact and forbid only the use of programme resources for administrative tasks. This is even the case if cuts on administrative budgets are differentiated according to types of tasks, as is the case in the present downsizing operation in the Netherlands (policy making –20%, support services –25%, execution –10% and regulatory/supervisory services –20%). Indeed, under differentiated cut back targets, line managers are still free to fill in their total retrenchment target in a different way than supposed in calculating the target. Moreover, it is still true to a certain extent if the target for the administrative budget is accompanied by a total staff cut-back target, as is also the case in the present downsizing operation in the Netherlands: line managers can still fill in the total staff reduction target in a different way than supposed in the computation of the target. It is true, however, that in this case, there is a real encroachment on managerial authority because staff reduction targets can no longer be filled by cuts in average pay levels, outsourcing or external consultancy. In sum, although *ad hoc* downsizing operations on administrative budgets may entail a certain limitation of managerial authority of line managers, especially if they are accompanied by staff reduction targets, in general this limitation should not be seen as dramatic or incompatible with broad managerial authority over input use.

Sharing support services is another recent development. Re-concentration of ministerial support services means that ministerial line

managers share more support services with each other, but this is a return to the past and nothing new. As was mentioned above, some sharing of support services between ministries/agencies of different ministries has also existed in the past but was largely abolished during the New Public Management era. The current trend in many OECD member countries is the establishment of new shared support service units or the rebuilding of those that existed in the past, sometimes on the still-existing vestiges of the previous organisations.

Establishing or rebuilding shared service centres can only be done by the co-operative effort of top managers of the concerned ministries. Usually these efforts are inspired by the political necessity to deliver efficiency gains. However, the success of these initiatives is crucially dependent on the willingness of the co-operating ministries and agencies to transfer tasks to these centres. Establishing centres is one thing, transferring tasks is quite another. As it turns out, in the sample countries of this study, three rather different approaches are followed for transferring tasks. One, exemplified by Denmark relies on a top-down approach. The second, exemplified by Finland and the Netherlands relies on an incentive approach, whereby the incentive consists of a specified, temporary (*ad hoc*) cut-back target for support services. The third, exemplified by Sweden and the United Kingdom, relies on an incentive approach whereby the incentive consists of a permanent (automatic) or temporary (*ad hoc*) productivity cut, which is general (not specific for support services).

### ***Support services sharing in Denmark***

Denmark is pressing on with shared services on the basis of two motivations: creating a more attractive work environment for professionals in administrative and ICT disciplines against the background of a recruitment challenge and the need to achieve efficiency gains. There are two new,<sup>5</sup> shared services centres: the Division for Administrative Services in the Agency for Government Management and the agency IT Service Centre in the Ministry of Finance. The tasks to be transferred to the Agency for Government Management concern salary administration (payroll management), accounting and travel expense administration. An elaborate procedure for the task transfer has been set up. The procedure proceeds in two phases.

In the first phase the tasks to be transferred have been identified and best practices for the relationship between the shared services centre and the client ministries/agencies have been defined (in customer agreements). The remaining tasks of the local units in the ministries/agencies were reformulated. Furthermore, the employees to be transferred were identified

with the help of incentive schemes to assure that the employees transferred from ministries/agencies to the service centre were already handling the same specified tasks. In the second phase, resources and employees were transferred. This started with a pilot in which the Ministries of Finance and of Economic Affairs took part. Subsequently, the resources and employees of other participating ministries were transferred while taking account of the lessons learned in the pilot. This operation is still under way. At present, approximately 200 employees have been transferred. The shared services centre in the Agency for Government Management will grow to approximately 470 employees. This number is subsequently supposed to be brought back to 250 through retirement and natural attrition. A different approach is being followed for the IT Service Centre in the Ministry of Finance. Initially the IT Service Centre was placed in the Ministry of Taxation. Due to high forecasted initial costs and the fact that it is not yet clear how these costs will be recovered by reductions in ICT units in ministries/agencies, the responsibility for the IT Service Centre was moved to the Ministry of Finance in May 2009. The Ministry of Finance is presently considering how the implementation of the IT Service Centre should proceed.

Standard setting with respect to support services is in Denmark entirely concentrated in the Ministry of Finance. Standard setting for human resources resorts to the Deputy Secretary for Administrative Policy and the State's Employers Authority (an agency); for finance under the Economic Management Division of the Agency for Government Management; internal audit, procurement, internal and external ICT under the Deputy Secretary for Administrative Policy. Standard setting with respect to accommodation and facilities is largely left to the line ministries.

### ***Support services sharing in the Netherlands***

In the Netherlands, the approach followed is quite different. Basically, it consists of two separate tracks. The first track consists of the establishment of new shared services centres in the Ministry of the Interior and Kingdom Relations. Presently, there are three such centres: one for salary and personnel administration (P-direct), one for human resources expertise and facilities (post/mail, security, reproduction, catering, etc.) and one for archives. The build-up of these centres was partly based on the transfer of existing ministerial personnel. However, the savings in the line ministries/agencies have not been imposed by the Ministry of Finance by simultaneous reduction of ministerial budgets (as is the case in Denmark, where there is strict one-on-one relation between personnel being transferred and budget cuts).

The second track is the *ad hoc* downsizing operation that has been decided for all ministries and agencies for a period of four years. This operation has to provide the incentives for task transfer and to produce savings. It consists of a cut of administrative budgets, accompanied with personnel reduction targets: –25% for support services. However, it still leaves the ministries and agencies some freedom. Although the cut is differentiated for types of tasks (and thus dependent on the task mix of each ministry), it is imposed on the entire administrative budget and the entire employment of the ministry including its agencies. The ministry is free to fill in the cut in a different way than supposed in the calculation of the target (for instance, although support services have the largest target, the ministry is free to moderate this percentage if it can realise a larger than supposed cut on policy development for example). Furthermore, several interlocutors of the OECD team have expressed doubts about the effectiveness of the downsizing operation for better use of the shared service units and producing savings. First, it was said that the target (25% in four years, 6.25% per year) is not high enough to trigger fundamental reconsideration and decisions to transfer tasks to shared services centres. Such a target can also be realised by efficiency measures without any transfer of tasks. This led to a plea for a much higher percentage reduction on support services in the order of 40% or 50% in the next downsizing operation. Second, it was pointed out that the calculation of the target (for all tasks, not only support services) was based on future administrative budgets that included new policies, so that there is no cut at all, but only less growth. This means that efficiency measures can be evaded to the extent that the new policies are delayed or implemented in a different way than supposed. Thirdly, it was pointed out that the calculation of the target (again for all tasks) was based on formal employment numbers that included 5% vacancies. By realising a lower vacancy percentage efficiency measures could partially be evaded.

Standard setting with respect to support services has in the Netherlands been recently reorganised and is now largely concentrated in the Ministry of Interior and Kingdom Relations, except for finance and internal audit. For that purpose a new Directorate General Operational Management has been created. It consists of three directorates: one for organisation and human resource policy, one for internal ICT and one for housing, procurement and facilities. The human resources directorate is based on an existing directorate in the ministry. The directorate for internal ICT is largely build up from scratch. The directorate for housing, procurement and facilities has largely come over from the Ministry of Economic Affairs (procurement) and from other branches in the Ministry of the Interior. The three new shared service centres, which have the status of agencies, are also under the umbrella of the new Directorate General. The directorates of the new Directorate General set standards with respect to human resources,

procurement, internal ICT and accommodation and facilities. However, standard setting for external ICT (e-government), resorts under another Directorate General of the Ministry (General Administration, Directorate for Public Administration and Democracy) and so does shared service delivery in that area (the Foundation ICT Executive Organisation and the agency Common Administrative Organisation). Standard setting with respect to finance and internal audit are not in the Ministry of the Interior and Kingdom Relations, but in the Ministry of Finance and so are some shared services centres in these areas.<sup>6</sup>

### ***Support services sharing in Finland***

Finland has followed a similar approach to the Netherlands: the establishment of shared services centres combined with a downsizing operation to provide incentives for task transfer and to assure savings. A shared services centre was established and built up from 2005-08: the Financial and Personnel Service Centre. It is a merger of the Justice Administration, the Defence Administration, the Interior Administration, the Financial Administration and the University Administration. It provides shared services in the areas of invoicing, accounting, salary payment, personnel administration, ICT and travel administration. It has six regional units apart from the headquarters in Helsinki (after five regional units to be closed in 2010). The centre has a staff of 570 employees. It serves nine ministries and 60 agencies. Another new shared service centre has been established for ICT: IT Management. It started its operation in the beginning of 2009. It is organised as a unit in the State Treasury (a branch of the Ministry of Finance) and has two local units: Helsinki and Lappeenranta, with a staff of 40 employees. Apart from the Financial and Personnel Service Centre and IT Management, shared services centres already existed for procurement (Hansel, a public enterprise; employment 55) and for accommodation (Senate Properties; employment 276 with 13 regional units).

In Finland, savings have to be generated by an *ad hoc* downsizing operation with a target of 8% of administrative central government employment in 2011<sup>7</sup> and 12% of administrative central government employment in 2015. These targets are divided over the ministries, so the incentive has to come from the need to comply with the ministerial ceilings on administrative budgets.

### *Support services sharing in Sweden*

Sweden is a special case as far as support services are concerned. First, there is a long tradition of separation of policy making and policy execution, with the latter concentrated in independent agencies, not subject to ministerial responsibility as far as decision-making in individual cases is concerned. Second, since World War II, Sweden had one of the largest and most rapidly growing public sectors among of all OECD member countries, but in the mid-1980s and in the late-1990s the country experienced major economic and financial crises. These crises led to a series of major operations to streamline the central government, especially the agencies, prompted by the necessity to achieve major cuts in public expenditures and public employment. During this period the organisation of central government was in a permanent flux, including the organisation of support services. Only in the last few years has a certain stability been achieved.

The major problem facing the Swedish government in the area of support services is the autonomy of the agencies combined with the extremely small size of the core ministries relative to the size of the agencies: according to the Swedish snapshot, 4% of administrative central government employment is in the core ministries (4 620 full-time equivalents), 96% in the agencies (111 000 full-time equivalents). This implies that there are very few support services in the core ministries. Core ministries were always so small (on average 375 employees per ministry) that it made no sense for them to develop individual fully fledged support units. Moreover, there is the constitutional arrangement of collective government in Sweden that supposes a single Government Office, governed by a single board (the Cabinet). In this arrangement the Office of Administrative Affairs under the Prime Minister traditionally served as the single (shared) services unit under the Prime Minister. However, this almost ideal sharing arrangement for core ministries does not address the real problem in Sweden, which is the support services of the agencies.

There are no new shared services centres in Sweden. The two that existed traditionally still exist: the Office of Administrative Affairs under the Prime Minister's Office (not an agency but part of the Government Office), and the Legal, Financial and Administrative Services Agency under the Minister of Finance for the smaller agencies. The former provides all support services to the core ministries, the latter focuses upon invoice processing and payroll management (salary administration) as well as legal services for smaller agencies. The Legal, Financial and Administrative Services Agency is not a new shared services centre but its size is growing rapidly as more agencies make use of its services. Approximately 50% of the government agencies use the Legal, Financial and Administrative Services Agency for accounting services and/or salary administration. The



demand for these services is constantly growing. The agency also has a debt collection service used by approximately 100 agencies and it also serves as the “insurance agency” for the state agencies in general, including the (core) ministries. The agency that was established in 2006 *inter alia* for maintenance and development of competence and for the co-ordination, promotion and guidance of e-government (“Verva”) has recently been abolished. In the area of human resources (maintenance and development of competence), its tasks have been taken over by a new agency (KRUS) that can perhaps be seen as a new shared services centre. The role of Verva in e-government has mainly been taken over by an inter-departmental committee.

Sweden underwent a huge downsizing operation in the mid-1980s and the late 1990s. In 1988 there was an operation in which administrative costs were cut by 10% across the board over a three-year period. Paradoxically, this led to the closing down of some agencies that provided shared services to the administration as a whole. In the late 1990s central government employment was reduced by no less than 50%, mostly through privatisation, but also by laying off 20% of staff (50 000 employees). Presently, however, there is no downsizing operation in place that could provide an incentive to transfer tasks to the still existing shared services centres. Instead, the motivation to achieve efficiency in the area of support services has to come from persuasion and informal pressure, and particularly from the drive to achieve a “joined-up government” as proposed in the 2006 programme declaration of the government for the development of the public administration. According to this approach agencies must co-operate in the area of support services by voluntary agreement to provide services to each other. In addition, Sweden has a good procedure in place for automatic productivity cuts in the context of the budget process, which obviously provides a modest incentive for seeking co-operation in the area of support services (see section on automatic productivity cuts).

There are various units for standard setting in Sweden: *i*) the Division for Central Government Employer Policy of the Department for Public Administration of the Ministry of Finance; *ii*) the Swedish Agency for Government Employers; and *iii*) the National Financial Management Authority, an agency under the Ministry of Finance. The first and second operate in the area of human resources, the third in the area of finance (budgeting and accounting), internal audit and procurement. Standard setting for internal and external ICT has been taken over by State Secretary Group for Electronic Government. There is no government-wide standard setting for accommodation and facilities (agencies decide for themselves in light of their needs).

### *Support services sharing in the United Kingdom*

In the United Kingdom the shared services initiative goes back to the first Gershon report of 2004. Gershon was a former director of the General Electric Company who was responsible for the company's world-wide defence business. The Gershon report proposed GBP 20 billion savings on administrative expenditure to be realised in 2007/08, partly by sharing support services. The proposals were agreed by Cabinet in 2004. Another important report was the Varney report of 2006. Varney was a former director of Shell and CEO of British Gas. Varney made a report that implemented the staff cuts recommended by Gershon but in addition identified key changes necessary to create "transformational government" focusing on customer needs, shared services and professionalisation. This led among other things to the creation of the Service Delivery Unit in the Cabinet Office. Sharing of support services in combination with standardisation and simplification was supposed to potentially save 20% of the costs of support services in human resources and finance. In 2006 the Cabinet opted for the proposed internal provider model and asked the departments to adopt the shared service concept.

Since 2006 six shared services centres have emerged in six different ministries (Work and Pensions; Prison Service; Environment, Fisheries and Rural Affairs; Transport; Revenue and Customs; Defence). Five of them provide services in the area of human resources, finance and procurement; one only in human resources and finance. Two services centres provide only services to the core ministries in which they are located (Defence; Revenue and Customs) and can thus better be seen as an intra-ministerial concentration of support services rather than deconcentrated ministries. The same applies to two services centres that provide services to the ministries in which they are located as well as to their agencies (including independent agencies, so-called Non-Departmental Public Bodies or NDPBs<sup>8</sup>). Only two shared service centres provide services to another ministry than the one in which they are located (Works on Pensions serves the Cabinet Office and is planned to serve Children, Schools and Families; Prison Service serves the Home Office).

In the United Kingdom, the shared services concept is very much inspired by private sector practices. Shared services are seen as standardised business processes operated by a separate business entity for multiple internal and/or external organisations. Sharing services is more than just concentration or consolidation of similar activities in one location. Sharing services mean running these service activities like a business and delivering

services to customers at a cost, quality and timeliness that is competitive with market and internal alternatives.

In the United Kingdom, like in Sweden, task transfer has to come from persuasion and informal pressure. There is no specific downsizing target for support services in place. A crucial role is played by the Civil Service Steering Board, which consists of a subset of the Permanent Secretaries Management Group (which includes all permanent secretaries of the ministries). The Board functions as a strategic steering group for the shared services initiative. It is assisted by the Corporate Functions Board (in which a co-ordinating person for each shared service participates) and by the Shared Services Team in the Cabinet Office. However, in contrast to Sweden, since the first Gershon report, the United Kingdom has substantial savings targets in place for administrative expenditure. The budgets since 2007 have included 5% year-on-year cuts of administrative expenditures. These expenditures include much more than support services but they provide a stronger incentive than automatic productivity cuts, which generally do not exceed 2% per year. In addition, in July 2008 the Treasury launched the “Operational Efficiency Programme” (OEP), which widens the government’s value-for-money agenda and aims to achieve savings of GBP 4 billion by 2009/10 on administrative expenditures through benchmarking and the application of public sector best practice and through the use of private sector experience.

### *Organisational models*

Shared service centres have always existed. In the years of New Public Management their position weakened, but in recent years they have come into the limelight. Many new centres have been established. The resulting picture shows old, recently re-invigorated organisations next to new ones. Some are in core ministries, some in agencies and some in public enterprises or foundations, sometimes with private sector participation. In addition, organisational policy with respect to support services is still very much being developed. The resulting picture is highly country specific, determined by national constitutional arrangements, historical developments and recent policy initiatives. Briefly, there is no single organisational model, but a variety of models, each one still in development.

Table 2.1 tries to capture the present situation in Denmark, the Netherlands and Sweden (the only countries for which the present situation could be fully inventoried). The table includes all shared services centres that could be identified in the three countries and indicates in which of the seven task areas they are involved, with an indication of sub-areas if there

are more shared service centres in the same task area. Some (sub-)areas have been excluded from the table because the data could not be collected for this study, namely communication, archives, training and educational facilities for civil servants. Facilities (cleaning, post, reproduction, catering, security, car pools) are in principle included but the table does not provide a complete picture in this sub-area. Table 2.1 is extracted from a more general survey of the location of activities related to support services (including organisational policy and standard setting) that is provided in Annex D.

Table 2.1 shows that in the three countries shared services centres have come to development in most areas of support services. However, the picture is different per country.

Of the three countries, the Swedish model is the most de-concentrated with shared services centres, especially in procurement, internal ICT and external ICT, being developed in various lead agencies that already had advanced support units in the areas concerned. Simultaneously, Sweden has developed little sharing in areas such as human resources, internal audit and finance (apart from the Office of Administrative Affairs, which serves only the very small core ministries). Denmark has the most concentrated model, with all shared services in agencies under the Ministry of Finance: the Agency for Government Management for all support services except internal and external ICT and accommodation and facilities, and the Palaces and Properties Agency for accommodation (facilities being mostly outsourced by the line ministries). The Netherlands has, on the one hand, a concentrated model with shared services units being developed for all support services under central ministries responsible for standard setting and efficiency, but on the other hand a dispersed model in that the shared services units are being developed under different central ministries: human resources, procurement, internal ICT, external ICT and facilities under the Ministry of the Interior and Kingdom Relations (with internal and external ICT under a different Director General than the rest), finance and internal audit under the Ministry of Finance, accommodation under the Ministry of Housing and Environment.

Table 2.1. Organisational models

Country	Shared support centres	Support service	Located in	Staff
Denmark	AGM Division for Administrative Services	Human resources (salary administration)	Agency of Ministry of Finance	50
		Finance (accounting and invoice, travel)		97
	AGM Division for Economic Management	Human resources (ICT system for salary and pensions payment)	Agency of Ministry of Finance	28
		Finance (ICT systems for budgeting and accounting)		
	AGM Division for Transverse Digitalisation	Procurement (for central government)	Agency of Ministry of Finance	35
		External ICT (common projects with sub-national government)	Agency of Ministry of Finance	15
	National Procurement Ltd Denmark	Procurement (mostly for sub-national government)		10
			Public enterprise owned by central and sub-national governments	71
	Agency IT Service Centre	Internal ICT	Agency of Ministry of Taxation	60
		External ICT		
Netherlands	Palaces and Properties Agency	Accommodation and facilities (accommodation)	Agency of Ministry of Finance	142
	Agency Work Company	Human resources (expertise)	Agency of Ministry of Interior	491
		Procurement		
		Accommodation and facilities (facilities)		
	Agency P-direct	Human resources (personnel and salary administration)	Agency of Ministry of Interior	88
	Government Main Accounting Office	Finance (ICT systems for budgeting and accounting)	Ministry of Finance	
	State Audit Office	Internal audit	Agency of Ministry of Finance	300
	ICT Executive Organisation (ICTU)			
	Common Administrative Organisation (GBO)	Internal ICT	Foundation with private sector participation	612 <sup>a</sup>
	Government Buildings Office	External ICT		
		Internal ICT	Agency of Ministry of Interior	66
		External ICT		
		Accommodation and facilities (accommodation)	Agency of Ministry of Housing and Environment	958

Table 2.1. Organisational models (*cont'd*)

Country	Shared support centres	Support service	Located in	Staff
Sweden	Office of Administrative Affairs (only for core ministries)	Human resources (expertise, salary and personnel administration)	Prime Minister's Office	700
		Finance (budgeting and accounting)		
		Internal audit		
		Procurement		
		Internal ICT		
		External ICT		
		Accommodation and facilities		
	Agency KRUS	Human resources (expertise)	Agency of Ministry of Finance	157
	National Financial Management Authority	Finance (ICT system for budgeting and accounting: Hermes)	Agency of Ministry of Finance	
	Legal, Financial and Administrative Services Agency (only for small agencies)	Human resources (expertise, salary and personnel administration)	Agency of Ministry of Finance	175
		Finance (budgeting, accounting and debt collection services)		
		12 procurement authorities	Procurement	Agencies of various ministries
Cluster co-ordinating authorities	Internal ICT	Agencies of various ministries	n.a.	
	External ICT			
	National Property Board	Accommodation and facilities (accommodation)	Agency of Ministry of Finance	389

The various models are clearly related to the constitutional arrangements and long-standing task divisions between ministries in the three countries. From the point of view of efficiency and savings, there are no obvious advantages or disadvantages of concentration or de-concentration of shared service centres. More important from these perspectives is the responsibility for standard setting with respect to support services. In Denmark and Sweden these responsibilities are mostly concentrated in the Ministry of Finance or agencies under its responsibility.<sup>9</sup> This setup makes it possible in principle to follow a top-down approach in which support service personnel is transferred from line ministries and agencies to the shared services centres under simultaneous one-on-one reduction of the line ministries' administrative budgets as has been done in Denmark (but so far not in Sweden). In the Netherlands these responsibilities are divided over the Ministry of the Interior and Kingdom Relations and the Ministry of Finance, which would make such an approach hard to achieve. The Netherlands is thus more or less obliged to rely on an incentive approach to achieve task and personnel transfer and efficiency gains. The downsizing operation is such an incentive, but it is too early to judge whether it is enough. Surely the operation will achieve its financial objectives (as did former downsizing operations), but whether it will achieve its specific aims of task and personnel transfer to shared services units and reduction of support service personnel, remains to be seen.

## ***Results***

Table 2.2 shows the savings targets for administrative costs of support services in Denmark and some sample countries that have downsizing operations in place (Finland, the Netherlands and the United Kingdom). The numbers for Denmark and the United Kingdom refer exclusively to the gains from sharing, the numbers for Finland<sup>10</sup> and the Netherlands are the total saving targets for support service personnel (regardless whether they come from sharing or from efficiency measures inside ministries and agencies).

The savings targets of Table 2.2 for Denmark and the Netherlands are those that are actually imposed on the ministerial ceilings in the medium-term expenditure framework. For Finland and the United Kingdom they are the estimated savings potential for 2015 respectively 2020 (only a proportional part of it is imposed on the current expenditure frameworks). Given the good budgetary discipline in the countries concerned it is relatively certain that these targets will be achieved. However, in the downsizing countries (all but Denmark), there is always the chance of leakage from other task areas (policy making, execution, supervisory/regulatory services). Downsizing operations may have specific

targets for support service personnel, but they are imposed on ministerial budgets, allowing ministers to shift personnel between task areas. As argued above, this is even the case if the financial targets are accompanied by personnel targets, as is the case in the present downsizing operation in the Netherlands.

**Table 2.2. Saving on support services in selected sample countries  
(million euros)**

	Denmark (2009)	Finland (2015)	Netherlands (2011)	United Kingdom (2020)
Human resources: salary administration	7	49	n.a.	n.a.
Human resources: other	–			
Finance: travel	2		n.a.	n.a.
Finance: other	15			
Internal audit	--	n.a.	n.a.	n.a.
Procurement	--	n.a. (120 in 2008)	n.a.	n.a.
Internal ICT	57	8	n.a.	n.a.
External ICT			n.a.	n.a.
Accommodation and facilities	--	n.a.	n.a.	n.a.
Total	81	235	220 <sup>a</sup>	1 189 (= GBP 1 068) (56 in 2008, 743 in 2014 <sup>b</sup> )

a. Namely the support services share in the total savings.

b. Assuming a linear increase in the savings that are targeted for 2020.

Table 2.2 clearly shows that the savings target of Finland is relatively ambitious. It is true that it has to be achieved only in 2015, whereas the Dutch target has to be reached in 2011, but the Netherlands has a much larger central government (roughly five times as large whereas the savings targets in both countries are of the same order of magnitude). Denmark's target is much smaller but has to be achieved only through sharing (Denmark has no downsizing operation on support personnel). The United Kingdom target too, is for sharing only (although the United Kingdom has a downsizing operation in place). Compared to Denmark it seems almost the same (central government employment in the United Kingdom is 14 times as large as in Denmark, its savings targets are also 14 times as high), but in fact the numbers are incomparable because for the United Kingdom they represent targets to be achieved in 2020, whereas for Denmark they are savings already realised. In general, the savings realised by sharing support services can be considered as modest in relation to total current operational expenditures of central government, but they are substantial in relation to the



total costs of support services (which are between 5% and 20% of current operational expenditures).

## Financial management

We will not describe in detail the budget process of the sample countries. Over the last decade, the OECD has undertaken budget reviews of more than half of the sample countries (Australia, Denmark, Finland, the Netherlands, Sweden)<sup>11</sup> (Blöndal, 2001; Blöndal and Kristensen, 2002; Blöndal *et al.*, 2002; Blöndal and Ruffner, 2004; Blöndal *et al.*, 2008) and many features of the budget process of all sample countries are available in the *OECD International Budget Practices and Procedures Database*.<sup>12</sup> However, for the issues that are addressed in this section, two characteristics of the budget process are particularly important and should briefly be mentioned, namely: the fiscal rule and the budget classification.

As for the fiscal rule, all sample countries aim at a medium-term goal of budget balance or surplus. In all countries except Australia and New Zealand, this is translated on the basis of a macroeconomic average growth assumption into a medium-term expenditure framework that specifies the budget ceiling for total expenditures, split out over ministerial portfolio's for the budget years and two, three or four subsequent years.

In Canada, Denmark, Ireland and Sweden the expenditure framework is rolling (with one out-year added annually); in Finland and the Netherlands it is periodic (valid for one Cabinet period, after which a new framework is established);<sup>13</sup> in the United Kingdom it is semi-rolling: extended every two years with possible revision for the third year of the previous framework. In the Netherlands, Sweden and the United Kingdom, the framework is fixed in the sense that the total ceiling in real terms cannot be changed from year to year except when compensated by structural<sup>14</sup> tax measures (but reallocation between ministerial ceiling is possible). This is known as an expenditure rule.<sup>15</sup> An expenditure rule in this sense provides for automatic macroeconomic stabilisation and multi-annual stability in ministerial budgets. In Canada, Denmark, Finland, and Ireland the expenditure framework is flexible in the sense that the total ceiling can be revised at the start of the annual budget cycle in light of macroeconomic circumstances and new political priorities as long as the medium-term goal of budget balance or surplus is not jeopardised. In Australia and New Zealand, there is no expenditure framework. Instead there is a so-called principles approach. Australia has a substantial annual surplus and no public debt. Both political parties are firmly committed to maintain these features of their budget policy. Moreover, Australia maintains a strict budgetary discipline on the multi-annual estimates (base-line spending on existing programmes). Under

these circumstances it can afford to assess the needs for new spending initiatives in the course of the annual budget negotiations without being bound by a previous top-down decision on an expenditure framework. New Zealand is committed to the principles of a prudent level of public debt and a positive operational expense balance but has not yet paid of public debt or realised a an operational surplus.

As for the budget classification, all sample countries have in the last decade revised the appropriation structure to make it more programme-oriented. Input line items have largely been abolished, but separate administrative budgets (current operational expenditures for personnel, material costs, outsourcing, travel, etc.) have been maintained either at the ministerial level or at the programme level. Parliament is supposed to wield its power of the purse on the basis of output and outcome information provided in the budget documentation, rather than through scrutiny of input line items.<sup>16</sup>

### *Steering and control of agencies*

In Sweden there are some 250 agencies with a large degree of autonomy: the minister is in general responsible for performance but not for the handling of individual cases.<sup>17</sup> There are general decrees for all agencies,<sup>18</sup> a specific ordinance for each separate agency and the annual appropriation direction for each separate agency for each budget year. In Denmark there are some 2 000 independent agencies<sup>19</sup> and some 50 arm's-length agencies, the latter under full ministerial responsibility. Independent agencies are governed by approximately 20 sectoral laws and approximately 50 departmental orders. Arm's-length agencies are governed by departmental orders. Both independent agencies and arm's-length agencies must conclude performance agreements in connection with the annual budget process. In the Netherlands there are some 700 independent agencies<sup>20</sup> and some 40 arm's-length agencies. Independent agencies are governed by many sectoral laws, government decrees and ministerial decrees. In addition, each independent agency must have a separate basic law. Arm's-length agencies are based on statutes contained in ministerial decrees. Arm's-length agencies must conclude performance agreements in connection with the budget process.<sup>21</sup>

More than anything else, the procedures for the steering and control of agencies have been influenced by New Public Management.

Core ideas of New Public Management in this area are:<sup>22</sup>

- separation of policy making and policy execution;

- decentralisation of management authority for policy execution to the managers of agencies;
- steering and control of agencies on the basis of outputs.

These ideas were strongly influenced by management practices in the private sector. They prompted the agency movement in the 1980s, starting in New Zealand and the United Kingdom (“Next Steps agencies”) and taken over by the Netherlands and other countries.

Steering and control on the basis of outputs has not always led to the efficiency gains that were expected. On a practical level staff numbers in agencies increased. In some countries, the Netherlands among them, there were even indications that programme resources (transfers, subsidies, social benefits) had leaked into administrative budgets.

On a more conceptual level, many governments struggled with the implementation of output steering and control. The conceptual difficulties are threefold:

- outputs are difficult to measure;
- politicians are interested in outcomes, not in outputs;
- what does steering and control mean on the basis of outputs if the outputs realised deviate from agreed outputs underlying budget estimates.

These difficulties will now briefly be explained.

Measuring the outputs of agencies is generally considered as feasible, in contrast to output measurement of policy-making units. The main difficulty here is the extent to which output definitions should take into account the heterogeneity of the services being provided. Police services in urban areas are somewhat different than police services in rural areas. Prison services for long-term detainees are somewhat different than prison services for short-term detainees. Providing student grants to students living with their parents is somewhat different than providing student grants to students living on campus or studying abroad. Hospital treatments are of hundreds different types. Much of the frustration of agency managers about output steering and control is due to insufficient recognition of the heterogeneity of the services provided.

Ministers have an interest in social and economic outcomes for which they are held responsible by Parliament and public opinion: less criminality, more growth in underdeveloped regions, lower school drop-out rate, etc. This induces a tendency to carry over the responsibility for outcomes to agencies but agencies cannot bear this responsibility for three reasons. First,

agencies cannot control outcomes since they are dependent on many social and economic factors over which they hold no sway. Second, outcome targets as formulated by politicians are a mixed bag. For instance, in the area of health care: shorter waiting lists in hospitals, more emphasis on preventive health care, more emphasis on service by general practitioners, small hospitals should be kept open, etc. Although in theory such dimensions of good health care can be ordered in a hierarchical tree of objectives, intermediate objectives and means (outputs), in practice politicians have great difficulty in reaching agreement in such an exercise. Consensus building on policy structures is impeded by underlying different political visions on what constitutes good health care, solidarity with the sick and the poor, etc. The end result is usually a compromise in which means and ends are mixed up in a rather arbitrary way and ultimate outcome targets are defined in a rather vague and little operational way.<sup>23</sup> Such outcome targets can never be the basis for agency management. Third, even apart from political differences about outcomes, the relationship between outputs and outcomes is never straightforward. The relationship between outcomes and separate outputs (services delivered) is always open to discussion. Indeed this is the main subject of social research and evaluation of sectoral policies. Underachievement on outcomes may be caused by underachievement on outputs, but this can never be concluded by the inspection of outcome measures alone. This is rather a matter of policy assessment and evaluation for which ministers and parliamentary committees hold a responsibility which they cannot carry over to agencies.

New Public Management theory has never provided a clear answer on what must happen if output targets underlying budget estimates are not realised.<sup>24</sup> Should agency budgets be cut retrospectively or for the future? Should they rather be increased because apparently they were based on a unit cost-price that was too low? Should sanctions be applied towards the agency management? However, this question rarely arises in practice. Budgets get slashed and managers dismissed but usually not because output targets were not achieved. The reason is that agency budgets are not based on output targets, but rather on actual outputs (services delivered) and recognised input costs. Agencies that deliver individual services in kind based on entitlement laws (often independent agencies or non-profit institutions controlled by government such as health providers, educational establishments, homes for the elderly, etc.) receive resources commensurate with the demand by eligible citizens, often with substantial input components,<sup>25</sup> regardless of output estimates in their budgets or multi-annual estimates. Windfalls or setbacks are for the minister to handle, not for the agencies. The budgets of agencies that deliver other individual services (for instance cultural institutions), collective services (police, army, infrastructure building agencies, etc.) or administrative services<sup>26</sup> are based

on a combination of input cost indexes and need indicators. If output targets are not met, or for that matter, overshoot, there are no automatic budgetary consequences: previously approved budgets and multi-annual estimates remain as they were, but output results may serve as a signalling device (Curristine, 2005), indicating that something is wrong with existing costing models or with the efficiency of the agency. However, this is always a matter for discussion that may lead to reform, but not to sanctions.

In spite of far-reaching New Public Management reforms that have taken place in all of the sample countries of this study, the practical and conceptual difficulties encountered have led to a certain re-orientation of thinking and to some new policies concerning the steering and control of agencies (Dunleavy, 2005; Osborne, 1997; Chapman, 2007). These new policies can be ranked under four headings:

- more emphasis on carefully defining outputs;
- less emphasis on the annual budget process as a tool for the steering and control of outputs; more emphasis on permanent performance dialogue;
- more transparency on input use by agencies;
- no price versus output split in budget negotiations, no split in ownership versus client roles of core ministries.

These new policies will now briefly be explained and illustrated by examples mostly from Sweden, which is by far the most advanced country when it comes to steering and control of agencies.

In Denmark and Sweden the initiative for defining outputs has been given to the agencies themselves. This precludes that agencies be responsible for outcomes and it assures that the heterogeneity of services is sufficiently recognised. Ultimately of course, the output definitions have to be agreed by both the agencies and the responsible ministers. However, it may be expected that the phenomenon of data manipulation and gaming, which is inherent to every arrangement of output steering and control, will be more manageable if the agencies are committed to the output definitions to begin with.

A tendency has come to the fore in the last few years in several countries to disconnect steering and control of output from the annual budget process. The annual exercise to reach agreement about output targets in the context of the budget process is increasingly seen as ineffective and bureaucratic, partly because output targets are not relevant for funding (which is based on actual outputs and recognised input costs), partly because there are better ways for steering and controlling outputs.<sup>27</sup> Sweden has

developed procedures over the past years that mostly by-pass the budget process, such as the annual performance dialogue with the minister on the basis of the annual agency report, the annual meeting with the National Audit Office on the basis of the audit report and various forms of evaluation (partly by external evaluation agencies, partly by the agency's internal in-depth analysis). Denmark and the Netherlands are also putting more emphasis on periodic agency evaluation. In addition, Sweden intends to reduce the annual agency direction attached to the appropriation. Henceforth, the remit of the agency and informational requirements on performance will largely be formulated in the agency ordinance and the agency direction will be limited to budgetary matters (carry over, conditions for charging fees, loans, guarantees and other financial conditions).

New Public Management changed the nature of the budget negotiations between the minister (or the top-management of the ministry) and the line managers of the executive units and agencies. Whereas traditionally these negotiations focused on the inputs required to produce the services that the minister desired, under the influence of New Public Management ideas the focus has shifted to the cost prices of the services. However, it has become clear that the shift is largely only in appearance. In the absence of competition, cost prices can only be assessed on the basis of underlying assumptions about the input mix and the input costs. Furthermore, in these negotiations the minister has leverage<sup>28</sup> over the line managers of agencies and can oblige them to reveal the underlying calculations.<sup>29</sup> However, sometimes agency managers succeed in hiding essential cost information. For the minister to steer effectively on efficiency, cost transparency is an essential condition. This allows the minister to pin down the cost price on other assumptions about the use of inputs than proposed by the line manager. The line manager still has discretion over the organisation of the production process, but has to live with cost prices agreed with the minister

In order to conduct negotiations with agencies in an effective way the minister has to be assisted by advisors that have thorough knowledge of the agency's internal organisation and production methods. Core ministries in Sweden increasingly invest in expertise on agencies' practices. Negotiation teams are often composed of financial specialists as well as policy specialists (the latter being aware of output requirements).

The New Public Management school has described the interaction between the agency manager and the minister by the so-called purchaser-provider model. In this model the agency manager decides on price and the minister on output. Since the agency is ultimately owned by the ministry, the top-management of the ministry not only has the responsibility to advise the minister on output but also to maintain the autonomy of the agency in the area of price-setting (the so-called ownership role of the top-management).

In practice this may mean that the top-management of the ministry has to protect the agency against excessive interference from the minister in its internal management affairs. However, this model is ill-conceived. As argued above the minister decides both on price and output. The budget process is the best occasion to decide on price, the permanent performance dialogue the best tool for steering and controlling output. The top-management of the ministry has no responsibility for protecting the agency against the minister, but should focus on its undivided responsibility to assist the minister in promoting efficiency and quality of services. In practice the ownership role of the top management plays a certain role in the Netherlands, where the Secretary General of the Ministry is sometimes appealed to if the Financial Directorate of the ministry cannot reach agreement with an agency director on budgetary matters. It is then difficult for the Financial Director to appeal to the minister, because formally the financial director reports to the same Secretary General. In Denmark and Sweden the ownership role is not recognised. The agency is self-owned. Moreover, in these countries budget negotiations are conducted directly with the minister or with line managers responsible for policy making, with the financial directorate in a subordinate role. This set-up entirely changes the character and dynamics of the negotiation and makes it more effective than the Dutch practice.

A final observation concerning the steering and control of agencies concerns the distinction between arm's-length agencies and independent agencies. In principle the fact that the minister is not responsible for the performance of the latter should not make a difference for steering and control: the minister can leave the control of output quality within the boundaries of the legal framework to the agency management but (s)he remains responsible for financing and thus for efficiency. This implies that the same steering and control instruments would be applicable: annual budget negotiations focusing on expected outputs and recognised input costs, a permanent performance dialogue about outputs, and regular evaluations. In practice, however, there appears to be a large difference in the ways that arm's-length agencies and independent agencies are steered and controlled, especially in Denmark and the Netherlands (in Sweden there are very few independent agencies). Why this is so is not easy to understand. In general there are no legal impediments against a more assertive role of core ministries towards independent agencies and basic laws of independent agencies generally recognise the rights of the minister to demand information and to decide on outputs and cost prices. As far as the Netherlands is concerned there seems to be a historic tradition of *laissez-faire* towards independent agencies ("*Zelfstandige Bestuursorganen*"), which is hard to change. Also, there seems to be a widespread feeling that firmer steering and control requires new legislation, which in general is not

the case, since existing legislation provides a sufficient basis for a more assertive role of core ministries. A first and important step would be to provide more extensive information about the outputs and budgets of independent agencies in the regular budget laws, as for the arm's-length agencies. A second step would be for each line ministry to announce a programme of evaluations of all its agencies (possibly including its arm's-length agencies). Such concrete steps could contribute to the transparency of agency operations and could enhance parliamentary interest and oversight.<sup>30</sup>

### *Spending review*

Some of the sample countries have used or have recently introduced special forms of policy evaluation in the context of the budget process, under names such as “strategic policy reviews” (Australia), “strategic programme reviews” (Canada), “interdepartmental policy reviews” (the Netherlands) and “spending reviews” (United Kingdom). These procedures are seen as a tool that can particularly support the allocative (priority-setting) function of the budget. There are three main differences with the policy evaluations conducted by line ministries: *i*) spending reviews not only look at the effectiveness and efficiency of programmes under current funding levels but also at the consequences for outputs and outcomes of alternative funding levels; *ii*) the Ministry of Finance holds final responsibility for the spending review procedure; and *iii*) the follow up of spending reviews is decided in the budget process.

The procedures for spending reviews have been quite different in various countries and have changed over time. Australia has recently started a new procedure based on selective and periodical policy reviews of spending programmes. The selection of programmes to be reviewed will be decided annually by the Cabinet. Canada used spending reviews in two *ad hoc* review exercises during periods of fiscal stress, in 1995/96 and 1998/99, in order to achieve savings. These procedures were not continued in subsequent years, but the present government intends to set up a more permanent procedure. Since the early 1980s, the Netherlands has used a procedure aimed at the annual review of a limited number of programmes to be decided by Cabinet. The number of reviews has varied widely between more than 30 in the first years to on average five to ten from the mid-1980s to 2007. In recent years the number of reviews has declined and the procedure seems to be in difficulty. Since 1998, the United Kingdom has used a procedure that looks in principle at all programmes (not selective), although not on an annual basis but rather connected to the biennial setting of fiscal aggregates (fiscal framework). For a selected number of programmes, independent or internal (Treasury) working parties are set up to treat specific problems (see Box 2.2).



### **Box 2.2. Spending reviews in the United Kingdom**

The spending review process was started in 1998 as part of a wider set of reforms to introduce a modernised public spending and performance management framework to support the prudent and efficient planning of expenditure over the medium term. This included:

- Greater stability through three-year spending plans to allow departments to plan ahead and to provide a more stable foundation for managing public services; spending plans, called spending reviews, were drawn up in 2000, 2002, 2004 and 2007.
- Separate capital and current budgets to ensure that essential capital investment is not squeezed out by short-term pressures.
- The introduction through subsequent years of accrual accounting and budgeting to improve the planning and control of spending and to increase the incentives to manage the assets effectively.
- The introduction of public service agreements, which for the first time set measurable targets for a wide range of the government's objectives for public expenditure programmes.

The stated aims of the 1998 spending reviews were to: reallocate money to key priorities, change policies so that money is well spent, ensure that departments work better together to improve services, and weed out unnecessary and wasteful spending.

The spending reviews lead to the biennial or triennial<sup>1</sup> revision of the total and departmental ceilings of the fiscal framework. The ceilings themselves cover three years so, where a two-year period has elapsed between spending reviews, the final year of the previous spending review period becomes the first year of the next spending review period, with departmental and overall ceilings revised if necessary (although in recent spending review periods no such revisions have been made to the final year). The spending review process focuses on expenditures subject to departmental expenditure limits (DEL) which cover around 60% of spending; the remaining 40% is taken up by annually managed expenditure (AME) which includes social security, debt interest, and other items of mandatory (often volatile) spending.

The spending reviews are informed by cross-governmental reports which are prepared either internally within the Treasury or by independent working parties whose terms of reference are decided by the Treasury. Examples of independent reports for the 2007 spending review were those on transport (Eddington Report), skills (Leitch Report), local government (Lyons Report) and climate change (Stern Report). Apart from these, value-for-money reviews are led by the relevant line ministries, with input from the Treasury and external working parties as appropriate. As part of the 2007 spending review, the government of the United Kingdom set a target for at least 3% cash-releasing net savings to be made across all departments in each year up to 2010/11. Administrative budgets will also be reduced by 5% each year in real terms to release resources for frontline services.

### Box 2.2. Spending reviews in the United Kingdom (*cont'd*)

Simultaneously, the line ministries prepare submissions that cover the three years of the next fiscal framework. The baseline of the departmental submissions is the cash budget of the previous year (the ultimate or penultimate year of the previous spending review period) on which the department identifies: new pressures, new priorities, and the scope for efficiency gains and reprioritisation. The submission includes updated objectives and outcome-based public service agreement targets and reforms. The submissions also have to respond to the cross-governmental reports on which the Treasury guidance is based.

The line ministry submissions are considered by the Treasury. Finally the Chief Secretary and Chancellor of the Exchequer (Minister of Finance) discusses the final proposals with the Prime Minister and Cabinet where appropriate, to resolve any final decisions. The final outcomes of the spending review are recorded in a White Paper, and individual settlement letters are sent to each department, setting out:

- current and capital DEL ceilings for the next three years;
  - new public service agreements and efficiency targets;
  - other conditions such as ring fences, policy reforms and limits for administrative budgets.
1. Spending reviews were conducted every two years between 1998 and 2004, but then a three-year period elapsed until the next spending review in 2007. The government retains the flexibility to decide whether future spending reviews should be conducted every two or three years, taking into account fiscal and political considerations. No specific requirements are set out in legislation with regard to this timing.

Apart from the final responsibility of the Ministry of Finance, these procedures have the following characteristics in common:

- assessments are produced by offices or working parties that are **not** under the control of line ministries;
- terms of reference for the assessments are established by the Ministry of Finance, the budget office, or the Cabinet;
- external experts are involved as chairs of working parties or as advisors.

Spending reviews may be selective in the sense that, in any given year or round of reviews, only a limited number of programmes are reviewed (such as in Australia and the Netherlands), or they may be universal in the sense that all programmes are simultaneously reviewed (such as in the United Kingdom). However, it is important to recognise that, in either case, only a small number of policy revisions – with or without budgetary consequences – arise from spending reviews. Generally, the vast majority of

sectoral policy revisions come from the initiatives of line ministries and are decided outside the budget process at any moment of the year.<sup>31</sup> Often these policy revisions also require new substantive legislation, and these bills are also discussed and decided in Parliament outside the context of the budget process. These policy revisions should be compatible, or made compatible, with budgetary ceilings, but the process of policy reform and substantive legislation itself is independent from the budget process.

It is also important to recognise that, in countries that use spending reviews, the policy revisions or legislative initiatives that do originate in the budget process – because they are triggered by the need to make ends meet – do not always come from spending reviews. This is true for countries that use selective reviews, but also for those that apply universal review procedures. A line minister who is responsible for a programme that is not considered in the review process or that is assessed as very efficient or effective in the spending review may nevertheless be asked to cut that programme simply because it is considered a lower priority in comparison to other programmes. In other words, in countries that use spending reviews, the resulting programme assessments are an important tool for the rational allocation of resources in the budget process, but they are certainly not the only tool.

Spending reviews are seen by the countries that use them as a better way to find resources to finance new priorities than more traditional tools, such as across the board cuts or cuts on subsidies. On the other hand, it is generally recognised that to be effective, spending reviews need permanent attention and support from the Minister of Finance and the Prime Minister. Lacking such attention these procedures tend to become less effective or they fade away. A firm legal framework for spending reviews, stressing responsibilities of the central ministries, may help provide such support.

### ***Automatic productivity cuts***

Productivity is defined by economists as the ratio of the value of output to the value of inputs. The problem for measuring public sector productivity is that outputs usually do not have market prices. Their value must therefore be estimated, and this estimation is usually based on the total costs incurred for their production (assuming a zero profit). With such an assumption, productivity of the public sector is unitary, and its growth is zero. However, this does not mean there are no productivity gains in the public sector.

Since the 1990s, there has been a general movement towards measuring public output and productivity gains. Some countries, such as Finland since

1993, have put in place programmes for estimating public sector productivity.

If productivity increases in the public sector are recognised, there is room for cutting the inputs of public sector by the rate of increase in productivity, without changing the level of output. This allows government to redirect savings from efficiency gains to higher priority programmes.

For goods traded on a private market, competition and the need to make profits provide incentives for efficiency. Public services are not subject to such incentives. Some countries have addressed this problem by implementing “automatic productivity cuts” to the amount of the estimated productivity gains, in order to put pressure on public sector production units to keep up with efficiency. In this report attention will be paid to the experiences of the five sample countries that use automatic productivity cuts: Australia, Denmark, Finland, New Zealand and Sweden. The Netherlands does not apply automatic productivity cuts.

How are the cuts established? Usually, automatic productivity cuts (also called “efficiency dividends”) take the form of across-the-board cuts on operational expense in terms of the economic classification of expenditures.<sup>32</sup> In some cases, a different rate is applied for different ministries (as for example in Finland). These cuts are either applied directly to the budgets of agencies (independent or arm’s length), or they reduce the budget of core ministries, who then have to pass on the cuts to their agencies in the proportion they choose, as long as they respect the overall cut.

In most countries in the sample, the cut rate is set politically, and ranges from 1-2%. Some countries have tried to link the target rate to productivity estimations, but these estimation-based procedures have drawbacks. On the one hand, public sector productivity is difficult to estimate and can easily be contested, which opens the door to political discussions every year about the cut rate; and on the other hand, this method implies changing the rate every year, which decreases predictability.

Countries that use automatic productivity cuts think they are useful to maintain efficiency incentives, but they are aware that there are several ways around these cuts. First, automatic productivity cuts are an incentive to create new programmes to compensate for cuts in existing programmes. Second, large portions of government are often exempted from the automatic cuts on the basis of political agreements. On the other hand, it should be recognised that the threat of being subjected to automatic productivity cuts, is an important incentive for the ministries that seek exemptions to agree with multi-year agreements that are satisfactory to the Ministry of Finance.

Methods for automatic productivity cuts are different between countries. Similarly, the ways in which these cuts are implemented vary: some are imposed on the estimates of the upcoming budget, some are imposed on the multi-annual estimates of the upcoming budget, and some are imposed on the expenditure framework that provides top-down steering to the annual budget cycle. Some country approaches will now be presented.

In the 1987-88 budget, the Australian Government introduced an efficiency dividend equal to an annual 1.25% reduction of departmental funding for Australian Public Service (APS) agencies (both arm's-length agencies and independent agencies). The efficiency dividend was reduced to 1% in the 1994-95 budget and remained at this level until 2005-06 when it was increased to 1.25%. In 2008, the Australian Government applied a one-off 2% efficiency dividend on top of the ongoing efficiency dividend. The efficiency dividend only applies to departmental operational expenses, *i.e.* salaries, operating costs and depreciation. The efficiency dividend is applied to the departmental expenses as authorised in the previous budget in order to arrive at the new budget estimate. After applying the efficiency dividend, the departmental expenses are indexed for inflation using the relevant Wage Cost Index. A small number of agencies are exempted from the efficiency dividend. The APS covers Commonwealth departments and agencies where staff members are employed under the Public Service Act 1999. Commonwealth funded agencies with different employment frameworks, such as the Australian Defence Forces, and State and Territory public services are not subject to the Australian Government's efficiency dividend.

Denmark started experimenting with automatic productivity cuts during the 1980s. They began by several 1-2% budget cuts applied across-the-board. Little by little, these cuts became automatic and permanently set at 2% of operating expenses. There was an attempt to rationalise these cuts by giving them an empirical justification based on comparisons with private sector productivity gains, but this attempt was short lived. Indeed, the estimations were controversial, leading to different productivity cuts each year and for each ministry, which only made implementation more difficult. There have been several attempts to eliminate the automatic productivity cuts, but none have succeeded. The first attempt was in 1993, by the newly elected Social Democratic Cabinet. But finally, only the estimation mechanism was eliminated, and the 2% flat rate was restored. When the present government came into office in 2001, there was a new discussion about this mechanism, but this did not lead to a change of the mechanism. The automatic productivity cuts are implemented in Denmark through the annual extension of the multi-annual estimates: the 2% cut is applied to the operating expenses in the last out-year of the previous multi-annual

estimates to arrive at the operational expenses in the last out-year of the new multi-annual estimates. This means that each cut is implemented in the multi-annual estimates four years before it has to be realised. Still, ministers can keep or increase their budget, by adding new tasks to their ministries. Once the operational expenditure estimates are set for each ministry, the minister allocates the money among its divisions and agencies. Again, the starting point of the negotiation will be the last out-year of the previous estimates minus 2%. Agencies then negotiate the budget in accordance with the new tasks required from them and the concrete problems they may encounter in realising the productivity targets. Apart from requesting additional funds for additional tasks, there is a second leeway which reduces the scope of the automatic productivity cuts: they do not apply to multi-year budget agreements. This leaves large portions of the government outside the scheme, as the Police, Defence, Education, etc. Today, 80% of total current operational expenditures are formally not subject to automatic productivity cuts. However, since in the absence of multi-annual agreements, automatic productivity cuts would apply, they strongly influence the contents of the agreements (the default alternative affects the agreement). Furthermore, the government has recently agreed on applying the 2% cut on all future multi-year agreements, which should increase the proportion of expenditures subject to the automatic productivity cuts as these are renewed. The gains from these efficiency cuts are used to finance new political priorities.

Finland has had an *ad hoc* downsizing operation in place since 2006. This operation can perhaps be extended to the next Cabinet term and be seen as the beginning of an automatic productivity cut. The size of the cuts is determined politically and set in the expenditure framework by the government. The target is a certain decrease in number of staff, which is then translated into operating costs savings. An average 50% of the estimated savings is cut out from the budget frame of the ministry (and reallocated to new policies by the government), and the other 50% is left within the ministry as an incentive. The negotiations of the targets are based on productivity plans prepared by each ministry. The targets may therefore differ from one ministry to the other, but the overall objective is an average labour productivity increase of 1% across government. Once a target percentage cut is set in the expenditure frame of a ministry, the ministry chooses how to allocate this cut among its divisions and agencies. The personnel reduction target represents budget savings of around EUR 20 million in 2007 and around EUR 150 million in 2011 to be reallocated by central government, plus similar amounts which will stay within the ministries.

New Zealand has a pragmatic approach to productivity cuts: instead of cutting operational expenses by a given percentage, it keeps to a fixed

nominal baseline. Given that the inflation rate has been around 2.5% for the last few years, this implies that ministries had to keep a focus on productivity in order to keep up with the desired level of output. There is a mechanism for “baseline review”, whereby the outputs are costed and the baseline reset accordingly, but these reviews are costly and only occur rarely.

Sweden uses actualisation indexes to put a “productivity pressure” on agencies. The multi-annual estimates are in real terms but annually converted into nominal terms by an aggregated wage and price index. The aggregate index is built using different indexes for each type of input in the agency’s budget, weighted by its importance (the mix of inputs might vary from one agency to the other). If the tasks are not changed, the budgets of agencies are the same as the previous year, corrected by the index. In order to keep a “productivity pressure” on agencies, the index used for wages does not fully account for the real increase of wages: the index is decreased by a moving average of the last ten years of productivity increase in the private sector (on the basis of the National Accounts, calculated by Statistics Sweden). Wages usually account for about 60% of an agency’s expenditures, but as the input mix varies from one agency to the other, the final index used to determine each agency’s new budget also varies. This method is applied to all the tax-financed agencies, with very few technical exceptions. Of course, some agencies are also financed by fees; in this case, the “productivity pressure” is smaller.

Automatic productivity cuts are a logical device in organisations that do not sell their products in markets. On the other hand, there are possible risks that tend to be emphasised by countries that have not adopted automatic productivity cuts. The most important risks are:

- Productivity gains differ between policy areas. If a single productivity estimate is used for the entire government sector or for central government, sectors with relatively low productivity growth suffer.
- The productivity growth percentage cannot be determined objectively. Public sector productivity may grow less rapidly than private sector productivity. Comparisons between public and private sector productivity in comparable areas (say, policy and the private security industry) are difficult and do not give any reliable results.

The first risk can be mitigated to a certain extent by flexible reallocation rules that allow ministers to move resources within their portfolios in accordance with productivity developments (which are partly also steered by ministers). The second risk can be mitigated to a certain extent by the choice

of a low productivity gain percentage (substantially below the market productivity development), for instance 2% per year. In the long run this will still lead to substantial savings. Although *ad hoc* downsizing operations can be useful to kick start shared services centres, they can possibly be dispensed with in the long run, if a stable regime of automatic productivity cuts is in place. This would lead to more predictability of budgets and more tranquillity in public administration.

## Questions emerging from the qualitative assessments

The present study focuses on a limited number of qualitative issues: shared services and some topics in the sphere of financial management. The Dutch government has requested a follow-up comparative study in which the organisation of central government will be studied more broadly. Issues in areas such as policy development and regulatory/supervisory tasks, that have not been included in the present study, could then be addressed as well. In addition a follow up study could widen and deepen the analysis on the issues included in the present study. In particular a follow up study could focus on a number of questions that emerge from the results of the analysis thus far. Such questions are:

- What would be the advantages and disadvantages of a “Danish” top-down approach to the further development of shared services centres? Would such an approach make it possible to dispense with *ad hoc* downsizing operations for support services? Is it necessary for such an approach for the finance ministry to take responsibility for organisational policy concerning support services or is such an approach also possible if organisational policy is located in another ministry and if yes, under which conditions?
- Is it possible to define an optimal final situation for service sharing? Which services should be shared on which scale? Should shared services also include other levels of government?
- What are the advantages and disadvantages of concentrating shared service centres in one or a few ministries?
- Is it possible to define an optimal regime of administrative autonomy for agency managers that on the hand stimulates managerial creativity and innovation and on the other hand safeguards operational efficiency?
- Is it necessary to increase the flexibility of human resource allocation within and between agencies?



- Would it be recommendable to differentiate the regimes of administrative autonomy of agency managers in relation to the services the agencies are providing, the risks involved in their operations, or the status of the agency (arm's-length or independent)?
- What would an optimal regime of output steering based on the concept of relational contracting outside the budgetary process look like? Who in the core ministry should be responsible for the steering of agencies and how should the steering process be organised? Should the regime be different for arm's-length agencies and independent agencies?
- What requirements should be formulated for the cost transparency of agencies?
- Can spending review procedures be institutionalised? Under which conditions?
- What would an optimal regime of automatic productivity cuts look like? Is it possible to design a regime of automatic productivity cuts that does not damage government tasks where productivity growth is slow or absent (education, culture)? Would such a regime make it possible to dispense with *ad hoc* downsizing operations?

## Notes

1. Note, however, that although standard setting is a policy-making task, in the task classification underlying the snapshots of the central government, it is not subsumed under policy making but under support services. Similarly, although support services delivery is an executive task, in the snapshots it is not subsumed under policy execution but under support services.
2. All support service units deliver services to other support service units. Human resource services are delivered to units for finance, procurement, etc.; finance services are delivered to units for human resources, procurement, etc.
3. On the other hand, some freedoms, for instance in the sphere of variable pay (bonus payments), have often lived on.
4. Personnel reduction targets were not always achieved. For instance, in the various personnel downsizing operations that took place in the 1980s and 1990s in the Netherlands, a substantial amount of the savings was realised in other expenditures than compensation of employment.
5. Other shared services centres existed already, such as those for procurement and for accommodation. See Annex D for a general survey.
6. The Government Audit Service is a recently established shared service unit for internal audit. The Directorate of Budget Affairs runs the budgeting and accounting ICT systems.
7. That is five years after the start of the operation, so approximately 2.5% per year.
8. There are 790 NDPBs in the United Kingdom with 92 500 employees in executive NDPBs.
9. In Denmark, the Agency of Government Management and (for human resources) the State Employer's Authority; in Sweden the National Financial Management Authority and (for human resources) the Swedish Agency for Government Employers. See Annex D for a survey.

10. Finland has also made savings by sharing outside central government; these savings are not included here.
11. The budget reviews are also available on line: [www.oecd.org/gov/budget](http://www.oecd.org/gov/budget).
12. The OECD International Budget Practices and Procedures Database can be consulted at [www.oecd.org/gov/budget/database](http://www.oecd.org/gov/budget/database).
13. This is a consequence of the coalition character of the Dutch and Finnish cabinets.
14. Not when compensated by autonomous tax revenues.
15. It became clear, however, in 2009, as a consequence of the financial crisis, all three countries were going to have to revise their frameworks in a one-off operation that is fundamentally at odds with the expenditure rule.
16. For recent reforms concerning programme budgeting and the budget classification see Kraan (2007).
17. In the snapshot, these (regular) agencies have been identified as arm's-length agencies. There are also some entirely independent agencies in Sweden.
18. The Government Agencies Ordinance, the Ordinance concerning the Annual Reports and Budget Documentation and the Ordinance concerning internal steering and control.
19. They include many educational establishments. Public hospitals are controlled and financed by the regions in Denmark.
20. They include the educational establishments for tertiary education. Hospitals are not supposed to be controlled by government in the Netherlands and thus in the (private) corporate sector.
21. There is no similar general obligation for independent agencies, but agency specific basic laws may contain conditions to such effect.
22. See Aucoin (1990); Boston *et al.* (1996); Dunleavy and Hood (1993); Hood (1991; 1998); OECD (1995); Osborne and Gaebler (1992); Pollitt (1993).
23. Inspection of the budget documents of countries that have attempted to provide this information in connection with budget estimates provides ample evidence for this observation.
24. The same is true, for that matter, for the theory of performance budgeting, in which the line minister is supposedly held responsible

- for outcomes or outputs *vis-à-vis* the minister of finance or the Parliament.
25. The budgets are based on demand estimates, but may also contain input-based components, for instance for capital investment, overhead, or average salary. In general, the costing models for agencies delivering entitlement services are very complicated.
  26. See Table 1.1 for the difference between service delivery and administration.
  27. In terms of institutional economics, the relationship between the minister and agency head can be characterised as “relational contracting” (Williamson, 1985). The agency budget can be seen in this approach as an “incomplete contract” that needs permanent specification during its execution. Relational contracting is characteristic for the entire service sector (also in private markets) and is caused by asymmetric information.
  28. Even if the relationship is characterised as a bilateral monopoly as is done in much of the public choice literature on bureaucracy, or as a principal-agent relationship as is done in much of the institutional economics literature, it is generally acknowledged that the minister can require the revelation of underlying cost information.
  29. In Sweden, the impossibility to hide relevant cost information is underscored by a far-reaching Freedom of Information Act. The law stipulates that everyone is entitled to access documents received or established by any government agency and that, subject to certain conditions, public sector employees are permitted to give out information to the media anonymously. No official investigation as to the source of such information may be carried out.
  30. Given the Dutch traditions concerning independent agencies, it is possibly recommendable to start with small and concrete steps and to avoid a design that can be seen as too grandiose. In 2003 an advisory committee (Kohnstamm Working Party) in the Netherlands proposed to review the legal position of all existing independent agencies, with the possible prospect of turning them into arm’s-length agencies. This attempt was shipwrecked in a wave of protest.
  31. This is also true, for that matter, in countries that do not use spending reviews. In those cases it is true as well that policy revisions may be decided in the budget process, but most are not.
  32. Operational expense consists of compensation of employees, intermediate consumption and depreciation on accruals basis.

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## *Annex A*

### **COFOG-Special Classification**

### **Collective goods in kind**

1. General governance services
2. Basic research
3. Defence
4. Public order and safety
5. Infrastructure and network services
6. Environmental protection, development and community services
7. Service regulation

### **Collective goods in cash**

8. Foreign aid transfers
9. General purpose and block grants
10. Interest

### **Individual goods in kind**

11. Non-market recreation, culture and religion
12. Social services
13. Health
14. Education
15. Market subsidies

### **Individual goods in cash**

16. Social cash transfers



The COFOG-Special classification is a modification of the regular COFOG classification. The latter is part of the national accounts. Regular COFOG distinguishes public expenditures according to spending purpose. COFOG-Special adds two distinctions according to spending motive, namely: between collective and individual goods and between goods in kind and cash transfers. In order to construct COFOG-Special, use has been made of the cross-classification of second-level regular COFOG and the economic classification for general government and of first-level regular COFOG and the economic classification for the sub-sectors of government.

Some explanatory remarks on the COFOG-Special groups are the following:

- General governance services: mostly second-level regular COFOG groups Executive and legislative organs, Financial and fiscal affairs and External affairs of regular first-level regular COFOG group General public services.
- Infrastructure and network services: second-level regular COFOG groups transport and communication of regular first-level COFOG group Economic affairs, but excluding subsidies.
- Environmental protection, development and community services: mostly first-level regular COFOG groups Environmental protection and Housing and community amenities but excluding subsidies.
- Service regulation: mostly (a) first-level regular COFOG group Economic affairs but excluding transport, communication, subsidies and transfers and (b) second-level regular COFOG groups not elsewhere classified (“overhead”) and research and development of first-level regular COFOG groups Education, Health, Recreation, culture and religion, Social protection, Environmental protection and Housing and community amenities, but excluding subsidies and transfers.
- Non-market recreation, culture and religion: first-level regular COFOG group Recreation, culture and religion but excluding subsidies. Social services: first-level regular COFOG group Social protection but excluding cash transfers.



## *Annex B*

### **Snapshots of the Public Administration**

**Table B.1. Australia: Central government employment in full-time equivalent (2008)**

	Policy development	Support services	Policy execution	Regulatory & supervisory services	Other	Total
Core ministries	18 959	17 017	3 312	4 112	4 112	47 512
Agencies under ministerial responsibility	11 878	17 474	23 870	10 736	2 741	66 699
Independent agencies	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total	30 837	34 492	27 182	14 847	6 853	114 210

**Table B.2. Denmark: Central government employment in full-time equivalent (2008)**

	Policy development	Support services	Policy execution	Regulatory & supervisory services	Total
Core ministries	5 272	151	n.a.	n.a.	5 423
Agencies under ministerial responsibility	796	989	23 092	5 288	30 165
Independent agencies	n.a.	n.a.	n.a.	n.a.	n.a.
Total	6 068	1 140	29 760	5 888	42 856

**Table B.3. Denmark: Support services split up in full-time equivalent (2008)**

Units labelled as support services in Table B.2	Human resource management	Information and ICT	Finance	Audit	Accommodation and equipment	Communication	Procurement	Total
Core ministries	15	n.a.	109	27	n.a.	n.a.	n.a.	151
Agencies under ministerial responsibility	40	169	263	35	416	n.a.	65	988
Independent agencies	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total	55	169	372	62	416	n.a.	65	1 139

**Table B.4. Finland: Central government employment in full-time equivalent (2006)**

	Policy development	Support services*	Policy execution	Regulatory & supervisory services	Total
Core ministries	4 550	850	n.a.	n.a.	5 400
Agencies under ministerial responsibility	n.a.	8 500	41 400	3 600	53 500
Independent agencies	n.a.	500	3 650	n.a.	4 150
Total	4 550	9 850	45 050	3 600	63 050

**Table B.5. Finland: Support services split up in full-time equivalent (2006)**

Units labelled as support services in Table B.4	Human resource management	Information and ICT	Finance	Audit	Accommodation and equipment	Communication	Procurement	Total
Core ministries	150	170	170	60	130	170	0	850
Agencies under ministerial responsibility	1 800	1 900	1 800	n.a.	1 650	1 050	300	8 500
Independent agencies	106	112	106	0	97	62	18	501
Total	2 056	2 182	2 076	60	1 877	1 282	318	9 850

**Table B.6. Ireland: Central government employment in full-time equivalent (2008)**

	Policy development	Support services	Policy execution	Regulatory & supervisory services	Total
Core ministries	8 750	15 959	24 829	6 410	55 948
Agencies under ministerial responsibility	n.a.	n.a.	n.a.	n.a.	n.a.
Independent agencies	n.a.	n.a.	n.a.	n.a.	n.a.
Total	8 750	15 959	24 829	6 410	55 948

**Table B.7. Netherlands: Central government employment in full-time equivalent (2006)**

	Policy development	Support services	Policy execution	Regulatory & supervisory services	Total
Core ministries	12 050	7 150	36 100	3 100	58 400
Agencies under ministerial responsibility	n.a.	1 100	59 800	3 600	64 500
Independent agencies	n.a.	n.a.	49 700	1 800	51 500
Total	12 050	8 250	145 600	8 500	174 400

**Table B.8. Netherlands: Support services split up in full-time equivalent (2006)**

Units labelled as support services in Table B.7	Human resource management	Information and ICT	Finance	Audit	Accommodation and equipment	Communication	Procurement	Total
Core ministries	1 639	1 191	993	854	1 508	966	0	7 150
Agencies under ministerial responsibility	1 100	0	0	0	0	0	0	1 100
Independent agencies	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	0	n.a.
Total	2 739	1 191	993	854	1 508	966	0	8 250

**Table B.9. Sweden: Central government employment in full-time equivalent (2008)**

	Policy development	Support services	Policy execution	Regulatory & supervisory services	Total
Core ministries	3 070	1 550	n.a.	n.a.	4 620
Agencies under ministerial responsibility	n.a.	25 150	81 070	n.a.	106 220
Independent agencies	n.a.	n.a.	n.a.	250	250
Total	3 070	26 700	81 070	250	111 090

## ***Annex C***

### **Corrected Central Government Employment**

Decentralisation, outsourcing, labour intensity and spending priorities are important factors that may explain central government employment next to service quality and efficiency. This annex presents the results of an exercise to “correct” for the former factors in order to shed more light on the latter. It consists of two parts. The first part focuses exclusively on decentralisation. The second part focuses on all of the mentioned factors simultaneously.

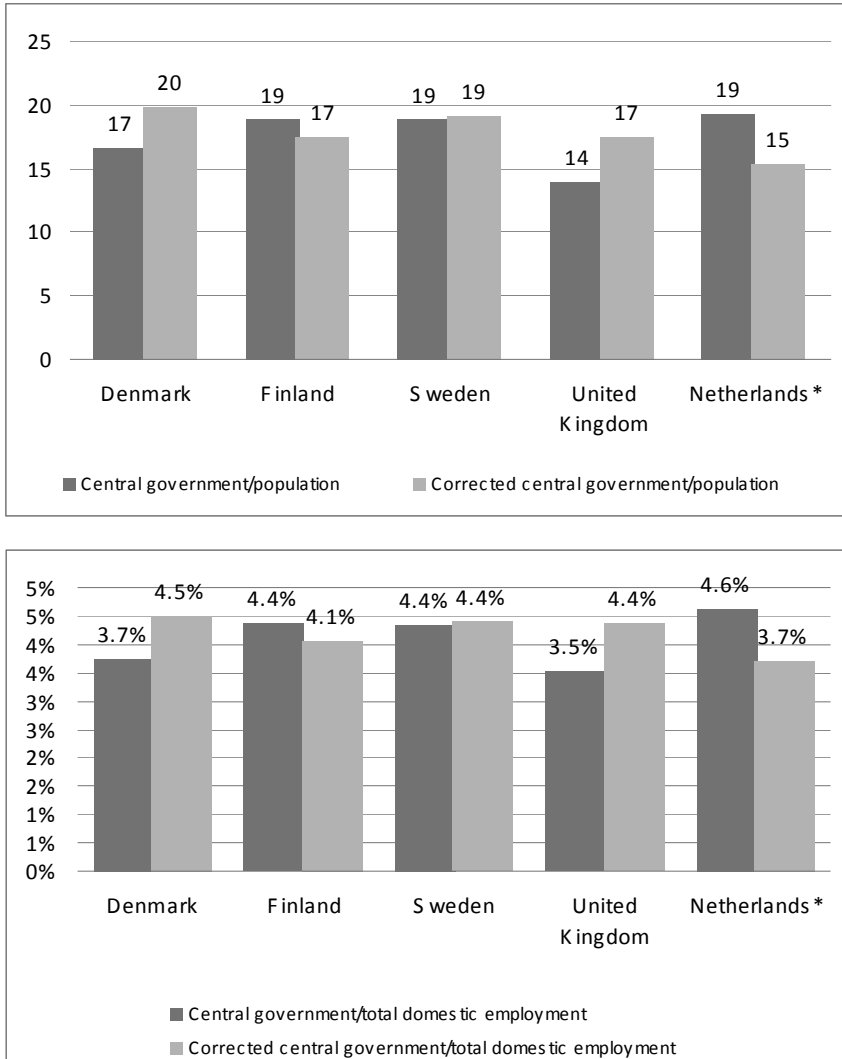
The calculation procedure that corrects for decentralisation starts from the employment numbers (in FTE) for central and general government. It computes the central government employment of each country, starting from the general government employment number, as if the centralisation rate for each policy area were equal to the average centralisation rate for each policy area over all countries. The results are shown in Figure C.1. It should be kept in mind that the figure shows in fact an indicator for the size of general government employment, although it is projected upon central government.<sup>1</sup>

As is to be expected, the correction increases employment in decentralised countries (Denmark, Sweden [only very slightly]) and decreases it in the Netherlands, which is very centralised. Surprisingly, the correction increases employment in the United Kingdom, which is also a relatively centralised country. The United Kingdom has relatively large employment in public order and safety, which is a very decentralised policy area, mostly because of the municipal police (centralisation rate 25, versus 68 on average). This leads to a large correction in this policy area in the upward direction that overwhelms the downward corrections in almost all other policy areas. The correction has a strong effect on the relative position of the Netherlands. Whereas the Netherlands had, together with Sweden, the largest central government employment (excluding health and education) before correction, it now has the lowest.



**Figure C.1. Central government employment excluding health and education corrected for decentralisation**

Full-time equivalents per 1 000 inhabitants (2006) and per cent of domestic employment in full-time equivalents (2006)



\* 2003.

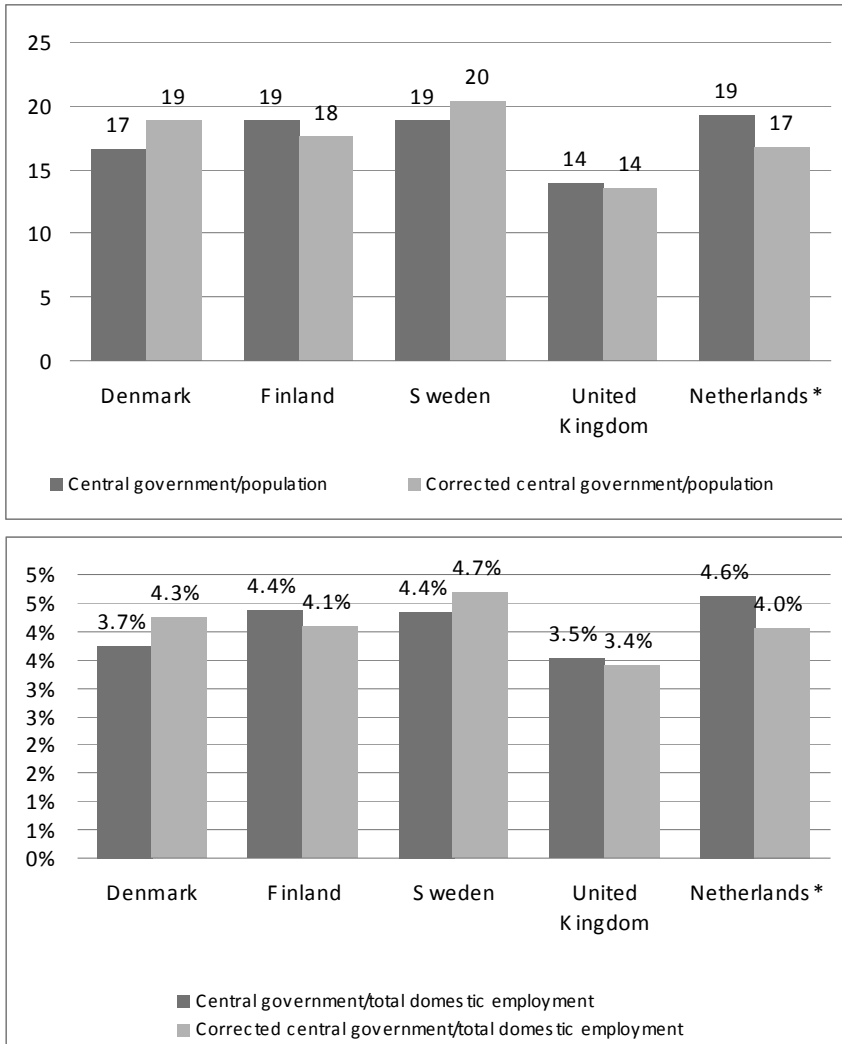
Source: OECD calculations based on the *Public Finance and Employment Database* (OECD).

The calculation procedure that corrects for decentralisation, outsourcing, labour intensity and spending priorities starts from the expenditures of central government on compensation of employment per policy area as a share of total general government expenditures. It computes the central government employment of each country, starting from total general government expenditure, as if the centralisation rate, the outsourcing rate, the labour intensity of production and the spending priorities were equal to the average rates and spending priorities over all countries. Since, if this were the case, the share of central government spending on compensation of employment per policy area in total general government spending would be the same in all countries, it is possible to compute “corrected” central government compensation of employment per policy area by applying the average shares to total general government expenditures and translating back to FTE employment numbers by applying the FTE/compensation of employment ratio for central government. The results are shown in Figure C.2. It should be kept in mind that the figure shows in fact an indicator for the size of total general government expenditures, although it is projected upon central government employment.

Figure C.2 shows that the corrections in Denmark and Sweden increase and in the United Kingdom and the Netherlands decrease. This suggests that differences in centralisation are the largest determinant of the corrections. Note moreover, that the correction of the United Kingdom now decreases as expected, because the correction assumes an average spending priority for public order and safety (namely 10% of general government spending on goods in kind, rather than 16% as is the case in the United Kingdom). After correction the Netherlands is now in second place, with the United Kingdom an even smaller corrected employment.

**Figure C.2. Central government employment excluding health and education corrected for rate of decentralisation, rate of outsourcing, labour intensity and spending priorities**

Full-time equivalents per 1 000 inhabitants (2006) and per cent of domestic employment in full-time equivalents (2006)



Source: OECD calculations based on the *Public Finance and Employment Database* (OECD).

## Note

1. The correction for centralisation rates is carried out per policy area in order to avoid different spending priorities affecting the result. However, since no policy area employment data for general government are available for the Netherlands and for Finland, the correction for these countries is carried out for the total centralisation rate (for government as a whole). This can cause some error because policy areas with relatively large employment compared to other countries have a stronger effect on the total centralisation rate than policy areas with relatively small employment. For instance, in the Netherlands general governance services, basis research, public order and safety, service regulation and social services are the policy areas with relatively large employment. If these policy areas had centralisation rates comparable to those of other countries but significantly different from the total centralisation rate (which we do not know), the correction on the basis of the **total centralisation rate** would be relatively large (because the large policy areas would affect the correction more than in other countries).

## *Annex D*

### **Standard-setting Units and Support Services Delivery Units**

Table D.1. Standard-setting units and support services delivery units in Denmark, the Netherlands and Sweden

	Standard setting for operational management		
	Denmark	Netherlands	Sweden
Human resources	Ministry of Finance: Deputy Secretary Administrative Policy, Centre for Administrative Efficiency and e-government  and  Ministry of Finance: Agency State Employer's Authority	Ministry of the Interior: DG Operational Management, Directorate of Organisation and HR Policies	Ministry of Finance: Department for Public Administration, Division for Central Government Employer Policy  and  Swedish Agency for Government Employers
Finance	Ministry of Finance: Agency of Government Management, Economic Management Division	Ministry of Finance: DG Budget, Directorate Budget Affairs	Ministry of Finance: Agency National Financial Management Authority
Internal audit	Ministry of Finance: Deputy Secretary Administrative Policy, Centre for Administrative Efficiency and e-government	Ministry of Finance: DG Budget, Director of Budget Affairs	Ministry of Finance: Agency National Financial Management Authority
Procurement	Ministry of Finance: Deputy Secretary Administrative Policy, Centre for Administrative Efficiency and e-government	Ministry of the Interior: DG Operational Management, Directorate Housing, Procurement and Facilities	Ministry of Finance: Agency National Financial Management Authority
Internal ICT	Ministry of Finance: Deputy Secretary Administrative Policy, Centre for Administrative Efficiency and e-government	Ministry of the Interior: DG Operational Management, Directorate ICT policy	State Secretary Group for Electronic Government

**Table D.1. Standard-setting units and support services delivery units in Denmark, the Netherlands and Sweden (*cont'd*)**

Standard setting for operational management			
	Denmark	Netherlands	Sweden
External ICT	Ministry of Finance: Centre for Administrative Efficiency and e-government	Ministry of the Interior: DG General Administration, Directorate Public Administration and Democracy	State Secretary Group for Electronic Government
Accommodation and facilities	Line ministries and agencies	Ministry of the Interior: DG Operational Management, Directorate Housing, Procurement and Facilities	Agencies, including: – Prime Minister's Office – Office of Administrative Affairs
Delivery of support services			
	Denmark	Netherlands	Sweden
Human resources	Line ministries and agencies  and  Ministry of Finance: Agency for Government Management, Division for Administrative Services	Line ministries and agencies  and  Ministry of the Interior: Agency Work Company  and  Ministry of the Interior: Agency P-direct	Agencies, including: – Prime Minister's Office – Office of Administrative Affairs  and  Legal, Financial and Administrative Service Agency  and  Agency KRUS

**Table D.1. Standard-setting units and support services delivery units in Denmark, the Netherlands and Sweden (*cont'd*)**

Delivery of support services			
	Denmark	Netherlands	Sweden
Finance	<p>Line ministries and agencies</p> <p><b>and</b></p> <p>Ministry of Finance: Agency for Government Management, Division for Economic Management</p> <p><b>and</b></p> <p>Ministry of Finance: Agency for Government Management, Division for Administrative Services</p>	<p>Line ministries and agencies</p> <p><b>and</b></p> <p>Ministry of Finance: DG Budget, Directorate Budget Affairs, Government Main Accounting Office</p>	<p>Agencies, including: – Prime Minister's Office – Office of Administrative Affairs</p> <p><b>and</b></p> <p>Ministry of Finance: Agency National Financial Management Authority</p> <p><b>and</b></p> <p>Ministry of Finance: Legal, Financial and Administrative Services Agency</p>
Internal audit	<p>Line ministries and agencies</p>	<p>Line ministries and agencies</p> <p><b>and</b></p> <p>Ministry of Finance: Agency State Audit Service</p>	<p>Agencies, including: – Prime Minister's Office – Office of Administrative Affairs</p>



**Table D.1. Standard-setting units and support services delivery units in Denmark, the Netherlands and Sweden (*cont'd*)**

Delivery of support services			
	Denmark	Netherlands	Sweden
Procurement	Ministry of Finance: Agency for Government Management, Division for Transverse Digitalisation, Procurement Subdivision  <b>and</b>  National Procurement Ltd. Denmark (SKl)	Line ministries and agencies  <b>and</b>  Ministry of the Interior: Agency Work Company	Agencies, including: – Prime Minister's Office – Office of Administrative Affairs
Internal ICT	Line ministries and agencies  <b>and</b>  Ministry of Finance: Agency IT Service Centre	Line ministries and agencies  <b>and</b>  Foundation ICT Executive Organisation (ICTU)  <b>and</b>  Agency Common Administrative Organisation (GBO)	Agencies, including: – Prime Minister's Office – Office of Administrative Affairs



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## Value for Money in Government

# Public Administration after “New Public Management”

Public administration has entered a new age. In the 1980s, “less” government was the prevailing idea; in the 1990s and early 21st century, “New Public Management” was the dominant theme. Today, public administration is moving in new directions. Reforms are focusing on the quality of services for citizens and businesses and on the efficiency of administration (the “back office” of government). The OECD is studying these new trends in a multi-annual, cross-country project called “Value for Money in Government”.

This is the first report in a new OECD series on the topic. The book examines four themes in nine OECD countries: the development of shared service centres, the steering and control of agencies, automatic productivity cuts, and spending review procedures. In addition, it contains a quantitative analysis of the size of employment in central government. The countries studied are Australia, Canada, Denmark, Finland, Ireland, the Netherlands, New Zealand, Sweden and the United Kingdom. The book pays particular attention to the case of the Netherlands, the country that first proposed an OECD study on value for money in government.

The full text of this book is available on line via this link:  
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