

Chapter 12

Steering of agencies

This chapter focuses on agencies of the central government. Agencies are defined as units of a ministry with a separate financial administration. They can be divided in arm's length agencies, that are subject to the ministerial responsibility as far as (executive) policy is concerned and independent agencies that are not subject to ministerial responsibility as far (executive) policy is concerned.

In most countries included in the study agencies have become the most important form of organisation in the central government. They employ a large majority of civil servants and they are the most used form of organisation for two of the four government tasks: policy execution and administrative regulation and supervision.

In the era of New Public Management the dominant view on the steering of agencies was the results oriented governance model. This model implied that agencies should be financed on the basis of outputs and costs. In practice this model has never fully been implemented. Agency outputs are hard to define, politicians often change their minds about output targets and sanctioning leads to perverse incentives.

Current steering practices evolve in the direction of a permanent performance dialogue between agency directors and officials in the core ministry who are responsible for policy development. A permanent performance dialogue makes it possible to steer agency activities from day to day in light of experience and new political demands.

As far as financing is concerned, current trends go in the direction of “capacity budgeting” which focuses on the costs of capacity to meet the politically agreed needs. Capacity costs can be divided into fixed and variable costs. Both types of costs are subject to negotiation between agencies and core ministries. At the side of ministries the finance directorates, as economic owners of the agencies, are the units most suitable to conduct these negotiations. However, the expertise of these owners on the costs of the production processes in the agencies can be improved in many countries.

The current chapter presents three reforms: one on the steering of outputs and two on the financing and ownership of agencies, which can lead to substantial efficiency savings.

Introduction

Agencies as organisations in central government

Agencies have been defined in this study as units of a ministry with a separate financial administration. They can be divided in arm's length agencies and independent agencies. The former are defined as agencies for which the minister is responsible as far as executive policy is concerned (not necessarily for the handling of individual cases). The latter are defined as agencies for which the minister is not responsible, nor for executive policy nor for the handling of individual cases. The minister remains responsible for operational management for both arm's length and independent agencies.

In most countries included in the study agencies have become the dominant form of organisation in the central government. As shown in Chapter 2, agencies employ the large majority of civil servants, they are the most used form of organisation for two of the four government tasks: policy execution and administrative supervision and regulation and they are used increasingly for support service delivery, especially at the central level.

In spite of this development, interest in the functioning of agencies has remained modest. This is regrettable because the organisational form of agencies is not without problems and it can be argued that the agency movement has led to loss of control on the efficiency of service delivery and the quality of services. For this reason the current study has paid much attention to agencies and the reforms that are currently taking place in the area of agency governance.

Chapter 2 has provided statistical information about the current role of agencies in the central government of the participating countries. Chapter 4 has paid attention to the distinction between arm's length agencies and independent agencies and focused on the role of these kinds of agencies in policy execution in various countries. It has also presented several reforms that are currently undertaken in the UK, Sweden and the Netherlands in reaction to the problems that have arisen (Reforms 4.2 and 4.4). Chapter 5 has paid attention to the use of independent agencies in administrative supervision and regulation. This current chapter focuses on the steering and financing of agencies, in particular administrative agencies (as opposed to agencies tasked with in-kind service delivery such as universities, hospitals, cultural institutions, etc.).

Whereas agencies have existed in several countries before the 1990s, in particular Anglo-Saxon countries and Sweden, the agency movement of the 1990s led to a more general shift of policy execution out of the core ministries, and into agencies, both in countries where agencies already existed, and in countries that thus far had organised policy execution mostly in the core ministries. Moreover, the agency movement, which started in the UK with the "Next step agencies" introduced by the Thatcher cabinet, added an important new component to the separation between core ministries and agencies, namely the results oriented governance model. This model was inspired by the ideas of New Public Management (see Chapter 1). This model implied that agencies should be financed and steered on the basis of outputs and costs. According to this model agency managers should have substantial autonomy in the organisation of the production process, in particular in decisions about the input mix, and should be accountable for outputs and costs per output. This model was introduced from the start in the new agencies established in the 1990s but was henceforth also applied to agencies that already existed in several countries long before the agency movement.

Problematic aspects of the results oriented governance model

The shift of policy execution and administrative supervision and regulation outside the core ministries is generally seen as successful in the countries where it occurred. The separation of policy execution from policy development has led to better insight in the costs of both tasks. Moreover, it is generally acknowledged that policy execution requires other forms of expertise than policy development, even if it is assumed that it may be useful for top managers to gain experience in both areas. In addition, the separation may in principle lead to better control of the production process, and thus to better services and lower costs, supposed that the steering and financing of agencies is well organised. However, this is currently not always the case, partly because of conceptual deficiencies in the results oriented governance model. These deficiencies are of three kinds.

First, output¹ is hard to define and heterogeneous. Financing of outputs becomes then illusory. A recent evaluation in the Netherlands showed that, in contradiction to explicit policy, input financing is in practice still dominant in agency financing arrangements (Ministry of Finance of the Netherlands, 2011). Integral cost prices play in practice little or no role in the negotiation between agencies and core ministries. Negotiations focus on the costs of inputs. Integral cost prices are sometimes calculated after the budget has been agreed between ministry and agency in order to comply with regulations that are based on unrealistic assumptions. Steering is not realised via output financing. Even if outputs are more or less homogeneous and definable, they are not used for financing, because most agencies are monopolists. Lacking market prices, their service costs can only be assessed on the basis of input costs.

Second, steering on outputs requires agreements about budgets and targets for quantity and quality of services. However, the quality of services cannot be captured in formal agreements. Steering on formal quality criteria, leads to perverse incentives. In the private sector, contracts play only a limited role in quality control. The basic quality ensuring mechanism in the private sector is competition in combination with the profit motive. Socialist experiments with steering on formal quality criteria in the private sector have failed (“Stalinist economics”). Moreover, in practice it appears that politicians continually change their minds on what has to be produced. This is logical, because political preferences change, insights in the usefulness of services change in the light of new social and economic research and social and economic circumstances change, affecting the needs for services. Therefore in practice steering takes place on a continuous basis by contacts between ministries and agencies, even if these contacts are not formally recognised as a steering mechanism.

Third, if formal targets for quality and quantity of services are not achieved, politicians are little inclined to apply financial sanctions². This is understandable, since politicians want to realise their targets. They would rather reform policies and increase expenditures than apply financial sanctions. This is only different if the shortfall in service provision is seen as a policy success. Many services are aimed at helping households or businesses in difficulty. In those cases the broader policy target is often to prevent that clients get in difficulty and need the service to begin with. This implies that successful policy implies reduction rather expansion of the service. This notion is captured by the expression “capacity budgeting”: budgeting for agencies should be based on sufficient capacity to provide the services if needed. Successful policy often means that the services are not needed.

Reforms of this chapter

In the Netherlands and Sweden, the recognition of permanent steering has led to a split in the roles of the core ministry in financing on the one hand and supervision of executive policy (steering) on the other hand. As soon as this split is recognised, it can formally be attributed to two different units in the core ministry. The financing role is often fulfilled by the permanent secretary, supported by the financial directorate. The steering role is often attributed to the policy making directorate (the tax policy directorate for the tax service, the directorate of law enforcement for the police, etc.).

This chapter contains three reforms that have been introduced in recent years to remedy the mentioned problematic aspects of the results oriented governance model for agencies. The first focuses on output steering in a permanent performance dialogue (Reform 12.1). The second focuses on financing of agencies (“capacity budgeting”; Reform 12.2). The third focuses on a more professional execution of the economic ownership role of the agencies, which includes the financing task (Reform 12.3).

Reform 12.1. Output steering in agencies

Characteristics of the reform

The reform consists of setting, monitoring and evaluating performance targets and realisations in a year-round performance dialogue. This task should be fulfilled by the line ministry that is responsible for executive policy of the agencies. It is important that the officials who are responsible for steering and control in the line ministry are the same officials who develop policy for the agencies. The strong side of this arrangement is that the dialogue becomes more meaningful because both parties have good understanding of the policy area.

Where did it occur?

In the last few years, the arrangements for the steering and control of agencies have been reconsidered and reformed in various countries. A prevailing trend in these countries is separating steering from financing of agencies. Sweden is in this respect the most inspiring country.

Analysis

Background of shifting from cost control to permanent performance dialogue

Agencies are not responsible for the effectiveness of policies. That is the task of core ministries who are responsible for policy design (see Reform 3.5 on Evaluation). However, policy design leads to the implementation of policy instruments and some instruments require executive actions (outputs). Financial instruments and some non-financial regulations needs to be applied in individual cases (paying grants, subsidies, social benefits, granting permits, licences, concessions, admissions), services in kind have to be produced and provided.

New Public Management had two consequences for steering and control of policy execution. First, it led in a number of countries to the separation of policy development

and policy execution. The latter task was devolved from ministries to agencies with a separate financial administration. This reform recognised that policy execution requires different skills and working methods than policy development and led in general to better results in the performance of both tasks. Second, it increased insight in the cost of outputs (both administrative services, such as payments of social benefits or subsidies, and services in kind such as employment mediation services and police services). These results are generally seen as positive.

However, New Public Management also changed the nature of the steering relation. When executive agencies were regular divisions of the ministry, steering of executive units took place on a daily basis in virtue of the regular ministerial hierarchy. The conception of New Public Management was that steering would henceforth be based on output targets and realisations, rather than on daily interference in the production process. Agencies would be autonomous as to the use of inputs and the input mix. Accountability would exclusively be based on output targets and realisations.

However, as argued in the introduction of this chapter, output targets are inherently volatile, both in terms of quality and quantity. New insights on the effectiveness of policies lead to reform of policy instruments. Moreover politicians change their minds in the light of new political priorities or new political agreements. For these reasons the process of performance steering must be a permanent process, in which agency activities can be adjusted from day to day.

Financing of executive tasks does not require daily adjustment. Within a broad margin the resources required for the execution of policy instruments can be held constant from year to year. Many costs are fixed and variable costs do not always need adjustment if new instructions are issued on the quality of outputs or the output mix.

Separating steering of agency performance from the annual budget process is an important trend in several countries. The annual exercise to agree on output targets within the budget process is increasingly seen as ineffective, bureaucratic and distortive (leading to perverse incentives). Output steering and control should take place on the basis of a permanent performance dialogue. The counterpart of the agency in this dialogue is not the financial directorate (as is the case in budget negotiations), but the directorate that is responsible for policy development.

Inter-ministerial agencies and service centres

A special case arises if agencies have the character of inter-ministerial common process units and shared service centres (see Reforms 4.2 and 6.1). In this case, the owner ministry is not only responsible for the financing and operational management of the common process unit or shared service centre but also for the effectiveness of the permanent performance dialogue between the client agencies and the management of the common process unit or service centre. In particular, the owner ministry has to ensure that the client agencies are represented in the team that conducts the performance dialogue and diverging interests among the clients are reconciled before the dialogue starts. The leading role of the owner ministry in the performance dialogue should guarantee that the client ministries cannot be played out against each other and that they are all served in accordance with their financial contribution (see Reform 12.2 for the partition of costs).

Sweden

Sweden has developed annual performance procedures that to a large extent bypass the budget process. Important elements are the performance dialogue with the minister (supported by the relevant policy directorates) on the basis of the annual agency report, the meeting with the Swedish National Audit Office on the basis of the audit report, and various forms of evaluation. With respect to performance reporting Sweden has reduced the role of the annual Agency Directive attached to the appropriation, and enhanced the role of the Agency Ordinance.

The Agency Ordinance, which is a set of rules put up for each separate agency, is the formal basis for the steering of Swedish agencies. It contains rules about the remit of the agency, its reporting requirements, ministry-specific rules of operational management and general instructions about executive policy. Next to the Agency Ordinance, each agency receives an annual Agency Directive that specifies its budgetary resources and contains instructions about performance targets. In addition to these formal documents, agencies are supposed to conduct a regular dialogue with their parent ministry about budget execution and performance results. The organisation of this performance dialogue is different between agencies. Large agencies, such as the Tax Office, have monthly meetings with the parent ministry, the Ministry of Finance in this case, and may have frequent contacts by telephone or email in between meetings. In the case of small agencies, the contacts may be less frequent. However, by way of principle, agency managers are supposed to conduct a continuous performance dialogue with the parent ministry. On the part of the ministry, the division that is responsible for policy development is the counterpart in this dialogue. Furthermore, in most cases, the minister meets with the agency management at least once a year to discuss the annual agency report.

In 2009 the Swedish government reformed its procedures for agency steering with a view to more stability and more pragmatic working methods. The Agency Ordinance (agency instruction) has become the key policy document for the government's management of agencies. The agencies are henceforth reporting performance in relation to their tasks in the Agency Ordinance. This reflects a change in approach based on the conviction that the agencies are generally in a good position to decide what information best describes their own activities. It gives the agencies more freedom in their reporting task. Furthermore it leads to consequences for the core ministries (the "Government Offices") as well, in that they can henceforth focus more on strategic matters. Finally, the reform has led to greater flexibility in the design of the government's reporting of results to the *Riksdag* (the Swedish Parliament).

In their annual reports, agencies must report and comment on the results of operations in relation to the objectives and tasks, and in accordance with the reporting requirements laid down in the Agency Ordinance. If the government has not determined special reporting requirements, the agencies are to report their performance in relation to volume, costs and quality. An agency's annual report is to be drawn up in accordance with generally accepted accounting principles, which implies that it has to give a true and fair picture of the results, costs, revenue and financial position of the agency. Annual reports are examined by the Swedish National Audit Office. The examination covers the entire annual report and aims to assess whether the report and the underlying report, as well as the accounts, are reliable.

Box 12.1. Steering of the Employment Service Agency (ESA)

The ESA is the largest agency (30 000 staff, 321 local offices, and annual turnover of SEK 70 billion) in Sweden. It is an arm's length agency subordinate to the Swedish Ministry of Employment.

The mission of the ESA is to help matching job-seekers and employers while prioritising people who have difficulties gaining access to the labour market. The ESA also promotes social inclusion. In 2012 the efforts of the Agency were focused on counteracting long-term unemployment and increasing the number of one-on-one meetings.

The steering of the ESA is performed on the basis of an Ordinance (Instruction 2007:1030), annual Directives and reports (30-40 reports per year). The forecasts for present and future needs prepared by the ESA five times per year can also serve as a supporting document for performance assessments. There is a permanent performance dialogue between the agency and the Ministry of Employment. Considering the large size of the Agency and the increased importance of the employment area in the post-crisis environment, the dialogue between the Agency and the Ministry is ensured by constant communication and frequent meetings. The Minister or the Director General of the Ministry meets on a monthly basis with the Director General of the ESA to discuss strategic issues. The meetings at the technical level take place twice per month or more frequently. Importantly, the performance dialogue involves relevant experts from both the Agency and the Minister who have good insights of the Agency's activities. On the side of the ministry, it is the division for employment (the largest of the seven divisions in the Ministry) which is responsible for policy development for the Agency and for its steering. An assigned expert from this department ensures the communication with the ESA. On the side of the ESA there are two contact persons to provide insights and any relevant to performance information.

According to the legislation, it is up to the agency to assess which kinds of performance are essential to its operations. Performance dialogue and assessment are supported by the information and targets provided in the Ordinance, annual Directives, and reports. The reports contain extensive information about results, statistics and facts of the ESA's activities and are being scrutinised through the ongoing dialogue between the parent ministry and the Agency. The recent trend in ESA performance management is further adjustment of the Ordinance as the key document for agency steering in terms of performance and removing all quantified targets (or replacing them by softer formulations that take better account of changing priorities) from the annual Directives. Removing quantified performance indicators or targets established from the annual Directives is intended to prevent unintended and distorting consequences of the performance assessment process. The focus in the performance dialogue has shifted from establishing performance indicators to scrutinising extensive reports and drawing conclusions about performance on a case-by-case basis. For instance, the targets established in the 2012 Directive included preventing long-term unemployment, early (preventive) interventions, and more frequent meetings with job-seekers. In 2012 the ESA had chosen to report customer contacts as its essential performance indicator.

Source: Provided by the Ministry of Health and Social Affairs.

Feasibility of the reform

A better separation of agency steering and agency financing is useful and feasible in most countries that have devolved policy execution to agencies. In this regard the Swedish procedures can be seen as best practice from an international perspective.

Reform 12.2. Financing of agencies

Characteristics of the reform

The reform consists of keeping financing of agencies apart from the steering of agency outputs. Budgeting of agencies should be based on robust rules for the fixed and variable costs of the agency's required production capacity in the light of the estimated needs for its services (capacity budgeting). Agencies should be required to provide transparent information on the input mix and the input costs that allow the owner minister to assess the capacity costs of the agency.

Where did it occur?

The separation of steering and monitoring from financing of agencies is a recent development in several countries that fits into the wave of current reforms aiming to remedy deficiencies of previous reforms that were inspired by New Public Management. Sweden is the clearest example. This country has a centuries-old tradition of devolving executive tasks to arm's length agencies. However, separation of policy execution from policy development is not the same as separation of steering from financing of agencies. In the 1990s the financing of agencies was affected in Sweden by the ideas of New Public Management in a similar way as many other countries, leading to an increased emphasis on output targets and performance in the financing of agencies. However, current Swedish reforms aim to remedy the unexpected consequences of this trend and go further in this respect than similar course corrections that are taking place in other countries. It can be argued that the long experience of Sweden with the financing of agencies, largely explains this early awareness of the need for adjustment.

Analysis

Budgeting of agencies and the budget cycle

Financing of agencies is generally provided from the State budget, although some agencies can generate their own revenues. Most agencies are part of the State; they don't have legal personality. This implies that their non-tax revenues, even if they are earmarked for the agency's services, are authorised by the state budget (the gross budgeting principle) and their use is subject to the control of the owner ministry. This is true for arm's length agencies as well as for most independent agencies in the sense of the current study (in particular independent agencies without legal personality³ (see Reform 4.3 for the specific features of independent agencies).

Countries have different practices concerning the authorisation of agencies' budgets. In most countries the expenditures for the services provided by the agency, for instance social benefits, subsidies, grants to local governments (programme expenditures), are kept apart from the operational expenditures of the agency and authorised in the budget of the core ministry. In Sweden however, the expenditures for the services provided are part of the agency budget and distinguished as separate line items within the agency budget.

Another distinction concerns the specification of the operational expenditures of the agencies. In some countries they are authorised in a single line item, which in principle allows large discretion for the agency's management to decide on the quality of inputs and the input mix. In other countries, the State budget authorises separate line items for broad input groups such as compensation of employees and intermediate consumption. If the operational expenditures are authorised in a single line item, the agency's budget is

sometimes specified on an accruals basis in the budget documentation. The latter is for instance the case in the Netherlands. This gives the government and parliament an insight in the operational management of the agency that can be used as background information for the assessment of the line item that authorises the agency's operational budget.

The financing of agencies is an annual process that is part of the regular budget process and subject to the same constraints. If there is a budgetary framework in place that puts ceilings on ministerial budgets, the ministries have to make sure that the operational budgets of all agencies under their umbrella fit into the overall ceiling for the ministry⁴. For this purpose the minister, often represented by the financial directorate of the ministry, has to negotiate with all agency heads in the same way as it has to negotiate with the directorates in the core ministry. If a country works with baselines that are regularly updated (see Reform 7.2) these negotiations usually focus on additional spending requested by the agency (above the baseline), or on savings proposed by the financial directorate (below the baseline). This process of intra-ministerial budgeting usually precedes the submission of budget requests by the line ministry to the Ministry of Finance. After the intra-ministerial budget process is completed, the minister takes a final decision on the allocation of the ministerial budget over all programmes and over the operational expenditures of all agencies and the core ministry.

In the 1990, as a consequence of the ideas of New Public Management, there were attempts in many countries to change the nature of budget negotiations between ministers and agency heads. Traditionally, the negotiations focused on inputs, but the focus shifted to the cost of service delivery (outputs). For this purpose it was necessary to define the services and to calculate total costs per service taking into account both the fixed and variable operational costs of the agency. In theory the budget negotiations could then focus on the service package to be delivered and the costs per service.

In practice this change has largely been fictitious because, in the absence of relevant market prices, costs can only be assessed on the basis of underlying assumptions about the input mix and the input costs. In order to carry out negotiations effectively, an agency's input costs therefore have to be transparent and the minister needs assistance from advisors having thorough knowledge of the agency's organisation and production methods. These advisors are typically to be found in the financial directorate of the line ministry. This implies that if the agency's services are steered by the policy divisions of the ministry (see Reform 12.1), there is a division of tasks between the financial directorate, that is responsible for efficiency, and the policy divisions, that are responsible for the quantity and quality of the services to be delivered by the agency.

This separation of responsibilities ensures that deficiencies in the quantity or quality of service delivery does not lead to budgetary sanctions and thus to perverse incentives. It also reflects the reality that politicians typically react to problems in the sphere of effectiveness by pushing for policy reform, not by withholding resources. This is understandable because the objectives they are trying to achieve do not become less valuable if current policies appear to fail.

The separation of financing from steering and monitoring implies that financing can focus on inputs. Inputs can be divided into fixed costs (buildings, overhead from management and support services) and variable costs related to the volume of services. For the purpose of financing it is important that services are broadly defined and not dependent on specifications on quality that are subject to the steering regime. This approach to variable cost financing is sometimes denoted as the $p * q$ approach.

Furthermore, the separation of financing from steering and monitoring implies that service volumes should not be interpreted as output targets, but rather as need indicators under given policies. Financing of agencies should ensure a sufficient service capacity to satisfy current needs, even if policy targets are aimed at reduction of needs. This can be called: capacity budgeting.

For instance, the costs of penitentiary institutions can be based on the normative costs of sufficient prison capacity and the expected number of incarceration days (not on targets for incarcerations days). The costs of primary education can be based on normative costs of buildings and equipment and normative teacher salaries in view of a student/teacher ratio (not on targets for “classroom hours”).

Currently, line ministries’ information about the costs of agencies is limited, particularly for the more autonomous arm’s-length agencies and the independent agencies. In view of the fact that by far the largest part of operational expenditure is made in the agencies, it is clear that substantial savings from efficiency improvements, if any, can only come from agencies (from all agencies, including the more autonomous and independent ones). In this light, there is every reason for governments to focus their attention on better cost information about agencies. Although the financial directorates should have the leading role in this effort, it is important that the Ministry of Finance supports this effort (Second line control, see Reform 12.3).

Inter-ministerial agencies and services centres

A special case arises if agencies have the character of inter-ministerial common process units and shared services centres. In this case, it is important that the ministry which owns the unit or centre remains fully accountable for its operational management and efficiency. This can only be achieved if the financing relation with the unit or centre remains firmly in the hands of the owner ministry. Otherwise the client ministries obtain a unilateral monopoly position and can be played out against each other. Whereas it is appropriate that the client ministries and agencies communicate regularly with the unit or centre about the modalities of service delivery in a permanent performance dialogue, it is important that the ministry that owns the unit or centre be exclusively responsible for its financing. This is the only way that accountability for the efficiency of the unit or centre can be made effective. The client ministries and agencies of the unit or centre can be made to “pay” for the services provided by common process units or service centres by inter-ministerial reallocation of the resources concerned. This will be reflected in the reduction of the line items from which the resources are taken (usually operational expenditures of core ministries and agencies).

Sweden

Sweden has made substantial progress in separating budgeting from output steering and monitoring, and in implementing procedures for the collection of reliable information about the costs of agencies. In Sweden agency budgets include both operational and programme expenditures.

Swedish agencies are subordinate to government and are not independent in the sense that they cannot set their own executive policies. On the other hand, they do enjoy autonomy, by way of principle, as far as decisions in individual cases are concerned. Also, they enjoy a certain autonomy with respect to the way they organise themselves and use their resources, subject, however, to standards of operational management that apply government wide.

Box 12.2. Financing of the Employment Service Agency (ESA)

The ESA is one of the 12 agencies under the umbrella of the Swedish Ministry of Employment. It is the largest agency in Sweden (see Reform 12.1). ESA is financed from the State budget. It also generates some small own revenues (from EU twinning projects, projects with developing countries or others). The budget of the Agency is developed in line with the central government budget cycle on an annual basis. The Agency prepares its draft budget for the upcoming year by March and submits it to the Ministry of Employment. In September, after discussions with the Ministry of Finance, the Ministry of Employment submits the draft budget to Parliament. The final version of the budget is adopted in December.

The budget appropriations for the ESA are distributed in four main groups:

1. operational expenditures (in the 2012 budget SEK 7 billion);
2. support to the unemployed (e.g. insurance payments, labour market educational programmes, activities support; in the 2012 budget SEK 31 billion);
3. specific programme costs (e.g. transfers to schools; in the 2012 budget SEK 8 billion);
4. wage subsidies (transfers to the employers hiring certain categories of employees; in the 2012 budget SEK 13 billion).

ESA is responsible for both operational expenditures (appropriations in group 1) and for programme expenditures (appropriations in groups 2 to 4).

Operational expenditures are subjected to cuts of productivity dividends (depending on the inflation rate the cuts vary from 1 to 3 % per year; see Reform 7.5). The programme expenditures are mostly defined by entitlements; therefore the agency cannot substantially influence expenditure levels under these budget lines or produce any savings. The baselines for expenditures under groups 2-4 are updated five times per year in light of forecasts. These updates can lead to supplementary budget laws. In the post – crisis period the forecasts about the unemployment level were often too pessimistic so that programme appropriations were not fully used.

Although the ESA is granted with rather broad spending authority, there are constraints with regard to the programmes to be undertaken and financed. These limits are defined by both the budget law (which specifies the separate appropriations) and by the annual Directive (see Reform 12.1). For example, the 2013 Directive stipulated that SEK 46 million should be spend on programmes stimulating youth employment and SEK 11 million should be directed to programmes promoting youth employment. Both programmes fall under group 3 of the budget appropriations. Constrained by programmes defined in the budget law and Directives, ESA could not spend all of its resources within a budget year. Underspending is often perceived by politicians and public negatively, but it also shows that the programme classification in the annual budget law and the Agency Directives are necessary constraints to avoid non-intended spending.

Summarising, the annual budget process of ESA is separated from the steering process. In this way perverse incentives are avoided. The established procedure of budget formulation ensures full transparency of input costs and allows the Ministry of Employment to assess the efficiency of the Agency's operations.

Source: Provided by the Ministry of Health and Social Affairs.

Feasibility of the reform

The Swedish approach to the financing of agencies is characterised by separation of financing from steering and control and by full transparency about input costs. In this approach the role of financing is limited to the insurance of service delivery capacity, whereas steering and control has to ensure performance. These features are not dependent on the specific nature of the Swedish agencies but are applicable in all countries that have organised policy execution in agencies with their own financial administration.

Reform 12.3. More professional ownership of agencies

Characteristics of the reform

The reform consists of a more professional execution of the economic ownership role of agencies by line ministries. This implies that the line ministries must improve the financing arrangement for the agencies under their umbrella, reserve more capacity in their financial directorates for the financing of agencies, collect more information about the efficiency of the agencies and ensure that central and de-central standards of operational management are applied by agencies. It also implies that the Ministry of Finance reserves capacity for the support of the financial directorates of the line ministries in their supervisory tasks and conducts comparative research on the efficiency of agencies.

Where did it occur?

In the Netherlands a new approach towards the steering of agencies was taken in 2011⁵. This change of cap was based on an evaluation of the agencies by the Ministry of Finance (2011). The new approach puts emphasis on a more professional economic ownership role of the line ministries. The document that announces the new policy contains a number of guidelines that are not yet fully implemented.

Analysis

If a central government would organise all policy execution in arm's length agencies, this would imply that the agencies would employ around 95% of all civil servants. This is illustrated in the case of Sweden, where policy execution is tasked to agencies by way of constitutional principle (according to the snapshot of the public administration the Swedish agencies employ 96% of central government officials; see Chapter 2). This implies that if a government wants to make savings on operational expenditures, it has necessarily to focus on the agencies. However, in many OECD governments, line ministries have lost detailed knowledge on the production processes in agencies, partly as a consequence of ideas of New Public Management that stressed the responsibility of agency managers for the efficiency of their operations. This knowledge must be regained in order to enable line ministries to fulfil their role as economic owners⁶ of their agencies.

The analysis of agency behaviour requires a distinction between three roles:

- the role of the agency as executive unit;
- the role of the line ministry as principal of the agency;
- the role of the line ministry as economic owner of the agency.

In the two previous reforms of this chapter, it was shown that in Sweden, the roles of the line ministry as principal and economic owner have to a large degree been separated. The role of principal is carried out by the division of the line ministry that is responsible for policy development in the domain of the agency, the role of economic owner is carried out by the finance directorate of the line ministry. In the Netherlands this separation has to a large degree been carried through as well. Of the 44 Dutch arm's length agencies (in 2010) in 36 cases the economic ownership was separated from the principal role. Economic ownership was in these cases tasked to the (Deputy) Secretary General, whereas the principal role was played by the Director General responsible for policy development. In the 10 remaining cases economic owner and principal was the same Director General. In the case of the 65 budget financed independent agencies economic ownership is vested in the Secretary General. In these cases there is no principal because the agency is independent as far as its executive policy is concerned.

Whereas in the Netherlands economic ownership is always vested in a single ministry, agencies may have more than a single principal.

Table 12.1. Number of agencies per Dutch ministry

	0 agencies	1-2 agencies	2-4 agencies	>4 agencies	Total number of agencies
Number of ministries	2	5	2	4	13

Source: Ministry of Finance of the Netherlands (2011).

Table 12.1 shows the number of agencies per ministry and Table 12.2 shows the number of principals per arm's length agency (independent agencies have no principal).

Table 12.2. Number of principals of Dutch arm's length agencies

	1 principal	2-3 principals	> 3 principals
Number of arm's length agencies	20	11	13

Source: Ministry of Finance of the Netherlands (2011).

The economic owner was previously defined in the Netherlands as the authority responsible for “continuity, quality and integrity of the agency”. The principal was seen as responsible for the “policy budget and the policy results”.

The previously mentioned evaluation report observes:

- Output is often hard to define. Steering on output is then hard to realise.
- Input financing is dominant for many agencies. This is particularly true for agencies that produce non-homogeneous services or specific government services (or fraud abatement) where there is a government monopoly of production of services with a social value. For these kinds of services the total cost-price is not decisive for the question which service level should be delivered; the general interest simply requires that the tasks are executed. In these cases steering takes place on the basis of available budget.

The evaluation also provides information about the number of officials in the finance directorates of the ministries that are tasked with the supervision of the agency finances (see Table 12.3).

Table 12.3. Supervision by Finance directorates of ministries on agencies in the Netherlands (number employees in FTEs¹)

Ministry	1.FTEs supervision	2. FTEs Fin. Dir. ²	1:2 in percent	Number of ALAs ³	Number of IAs ⁴
Prime Minister's Office	0	11	4	1	0
Foreign Affairs	1	70	0	1	0
Interior	7	109	6	10	6
Defence	8	323	2	3	0
Economic Affairs, Agriculture and Innovation	15	149	10	8	12
Finance	1	31	3	2	3
Infrastructure and Environment	11	176	6	4	5
Education, Culture and Science	6	39	15	2	14
Social Affairs and Employment	7	114	6	2	2
Security and Justice	2	44	5	5	8
Health, Well-being and Sport	3	75	4	6	14
Total	60	1 227	5	44	65

Notes: ¹Employment in full time equivalents; ²Finance directorate; ³Arm's length agencies; ⁴ Budget financed independent agencies.

Source: Ministry of Finance of the Netherlands (2011).

It appears from this table that 60 of the 1 227 employees of Finance directorates of ministries are tasked with financial supervision of agencies. Ministries that own many agencies devote on average more resources to supervision than ministries that own few agencies, but the relation is not without exceptions (for instance Health Wellbeing and Sport owns many agencies but has little supervisory staff).

However, the mentioned evaluation also concludes that further professionalisation of the various roles is necessary. For this purpose additional capacity and expertise has to be created in the Finance Directorates of the ministries via reallocation. Moreover, according

to the evaluation the owner needs to fulfil a stronger role that is currently the case. The owner must not only focus on the continuity and the quality of the agency but also on the financing framework available for spending. This role has to be filled in more actively, also during the execution year. The Ministry of Finance should also focus more on agency financing, among other things by stricter supervision on the budget and accounting process of agencies and by periodic evaluations together with the Finance Directorate of the line ministry. As indicated by several principals, agencies and owners, the Ministry of Finance should also play a more horizontal role by conducting comparative efficiency analysis of agencies.

On the basis of the evaluation the Dutch Government has taken a number of policy decisions on the steering of agencies, including:

- the roles of principal and economic owner should be fulfilled by different officials;
- the expertise on the functioning of agencies and on the execution of the various roles should be increased by the development of an educational and training programme that should be mandatory for the officials that fulfil these roles as well as for their advisors and supervisors.
- supervision and control of agencies should be strengthened, both in the first line (Finance directors of ministries) as in the second line (Ministry of Finance, DG Budget). The DG Budget have started horizontal benchmarks and evaluations of agencies together with the Finance Divisions of ministries (every five years, if possible aligned to regular spending reviews).
- the strengthening of supervision and control of agencies (both in the first and second line) requires additional capacity. For this purpose a reallocation of available capacity has to take place.

In view of these decisions, it may be concluded that the task of agency financing in the Netherlands moves from the principal to the owner. It is to be expected that these decisions will have far reaching consequences for the financing of agencies and will lead in the medium term to substantial savings. It is interesting to note that these decisions imply an almost total reversal of the steering philosophy that led to the establishment of agencies in the first place (financing and steering on outputs, “let managers manage”). However, these decisions do not in any way imply a weakening of the separation of the agencies from the ministries as such. On the contrary the separation of policy development from policy execution is still seen for many reasons as a successful result of the reforms of the 1990s on which the current reforms build on, albeit in a different direction than originally envisaged.

Feasibility of the reform

As a consequence of the “agency” wave of the 1990s many OECD countries have established executive agencies on arm’s length distance from the ministries. Moreover, in many countries there traditionally existed many agencies that were more or less independent, that were positioned under the umbrella of ministries and that were financed by these ministries (see Chapter 4). This is true for instance for several Anglo-Saxon countries (UK, Australia, Canada, New Zealand) but also for France and the Nordic countries. In many of these countries, governments have recently started to strengthen financial supervision on agencies, in view of increasing doubts about the effectiveness of output-steering arrangements that were inspired by the ideas of New Public Management. In France, for instance, there is currently a new wave of reforms aimed at improved

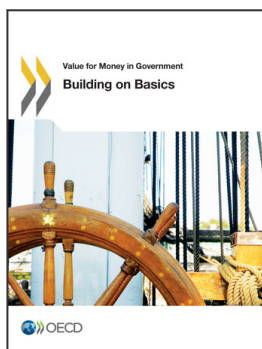
ministerial “*tutelle*” of the agencies. The Netherlands is one of the countries where this new approach has formally been adopted in government policy. The Dutch reforms are in principle applicable to all countries where arm’s length and independent agencies exist and can provide inspiration for reforms in these countries in a similar direction, leading to substantial efficiency improvements and savings.

Notes

1. For the use of the term output in this study see the glossary.
2. Sanctions may in principle take the form of budget reductions in a next budget year or of an arrangement, which specifies that budgets for services that have not been produced, must be returned (so-called after calculation).
3. In some countries, such as France and the Netherlands, some independent agencies have legal personality (public non-profit institutions in the sense of the National Accounts), but this is not the case in Sweden.
4. The expenditures for the programmes that are executed by the ministry are usually negotiated with the directorates of the core ministries that are responsible for these programmes.
5. Letter of the Minister of Finance to the Second Chamber of Parliament of 25 August 2011.
6. In a legal sense the agencies are owned by the State as a legal person. Economic ownership refers to the competence to decide on the use of the resources of the agency.

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