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Does anyone govern?
The relationship between the Government
Office and the agencies in Sweden

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Preface

According to the Swedish constitution, The Instrument of Government, Article 1, “The Government governs the realm”. The seventh chapter of the same document, dealing with the practical aspects of governing, declares that “Government offices shall exist for the preparation of Government business”, and that “In preparing Government business the necessary information and opinions shall be obtained from the public authorities concerned”. The division of responsibilities between the Government Office and the agencies is not further regulated in the constitution but derives from practice that has developed during a long time. The Swedish structure of today, based on small ministries and autonomous agencies, is not quite as old as is often believed, however. Even if the origin of this model goes back to the seventeenth century, what is today referred to as the Swedish model is largely a twentieth-century phenomenon.

Important changes have taken place in the political environment during the post-war era, in particular during the last two-three decades, and a discussion about administrative structures is well justified. Administrative reforms in other countries provide a natural starting-point for this discussion and play an important role in this report. On the other hand, it should be stressed that every country must find its own solutions to the problem of administrative design.

The report has been written within the framework of the SNS Constitutional project. The reason why public administration is on the agenda is not that we believe that the changes deemed necessary would call for constitutional amendments; in fact, our conclusion is the opposite. Rather, the question is how to create an administrative structure that realises the ambition of the current constitution that the Government govern the Realm. In our judgement, more political focus on governance issues, and a reallocation of administrative resources are sufficient. There are good reasons for preserving the basic tenets of the Swedish model of government – the collective responsibility of cabinet members for government decisions, the principle of public access to information, objectivity, and rule of law. The conclusions and recommendations of the report are our own.

A reference group consisting of persons with experience from the Government Office and agencies, chaired by Nils Gunnar Billinger, has followed the project. Valuable comments on previous versions have been made also by Daniel Tarschys and by colleagues at the SNS centre.

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Chapter 1 Introduction: What is the problem?

1.1 The international scene and Swedish administrative tradition

A wave of agencification is sweeping across the Western world. Initiatives that have been presented under this heading are “The Next Steps Initiative” in the UK, *agentschappen* in the Netherlands, and scattered examples in the US, Australia and Japan. The transition states in Eastern Europe and a number of developing countries have also made attempts to create autonomous administrative bodies – in many cases not altogether fortunate.

The common heading of *agencies* hides substantial differences, both within and between countries. Some carry out standard administrative tasks at arm’s length from the ministries, others are service providers close to state-owned companies in structure and behaviour and others again are entrusted with tasks that are aligned with the making of government policy. In spite of these differences, there is an international tendency to separate functions within government. No single dichotomy is able to render this process in its full complexity, but categories such as strategy/operations, rules/practice, or political goals/implementation together give an idea of the division of labour underlying on-going reforms. These changes are part of a wider process of public-sector reform that includes concepts such as performance, accountability, devolving authority, choice, responsiveness and competition (see OECD 1995 for an overview).

Against this general background, Sweden seems fairly well positioned, given its almost four-century long tradition of agencies, as well as a long tradition of local autonomy formalised in the second half of the 19th century but going back far longer than that.

Core features of Sweden's political-administrative structure include a small Government Office and a large number of independent agencies as well as municipalities with substantial autonomy vis-à-vis the state. These characteristics have survived the government's transformation from the watchman state with narrow responsibilities to a welfare state whose activities reach into virtually every area of society. The durability of this arrangement strongly indicates that whatever the shortcomings, Sweden will continue to be governed along these lines; the model will not be dislodged by findings, such as those in this report, that ministries fail to effectively govern the agencies under their responsibility.

But precisely because Swedish-style agencies are here to stay, it is important to highlight the method by which they are governed and its shortcomings. Basic standards of democratic accountability require that administrative entities should answer to political masters, so that the Government is able to come to sound judgement on public policies, the financial resources to entrust to these entities, and on whether changes should be made in their jurisdiction or operation. We believe that there is a need to strengthen the Government's ability to guide and oversee subordinate agencies.

In examining the ministry-agency relationship, it is appropriate to consider whether the issues raised in this report are new problems that have arisen because of changing demands on government, or long-standing problems that have been ignored. Is it the ban on ministerial rule, which precludes the intervention of policy organs in agency decisions concerning single individuals or legal personalities but which has often been given a much wider interpretation, that acts as an obstacle to clear thinking about government-agency relationships? Are particular ministries and the Government Office as a whole less equipped than they once were to give policy direction to agencies, and less prepared to monitor what agencies do, how they spend public money, and the results they produce? Are agencies, flush with resources and independence, less attuned than in the past to the dictates of their political paymasters? Or are there other, possibly more intricate mechanisms that dictate the way in which the system has come to be

structured, mechanisms that today are less fit than previously to deliver central government services?

These questions are of interest not only to Sweden, but also to other countries that have introduced the agency model or are considering it. Although it has made little headway in France, Germany and Japan — countries with powerful, centralised bureaucracies — agencies are a prominent feature of new public management in other countries. Britain has devolved the provision of public services to more than 130 “Next Steps” agencies that now employ three-quarters of the civil servants working in central government. New Zealand has de-coupled the policy and operational functions of government, and has introduced formal contracts, such as purchase agreements, between ministers and departments. Some transitional countries have created independent agencies in efforts to improve the quality and efficiency of services by weakening the central command-and-control regime maintained during the Communist era. Finally, a growing number of developing countries view the establishment of independent agencies as a means of accelerating national development and enhancing government performance.

Recent change in Sweden

In the mid-1980's several committees looked at issues related to the decision processes of central government (RRV 1994). A recurrent theme was the perceived difficulties to govern the public administration. The reforms that followed during the late 1980's and early 1990's, based on the concept of performance management, represented an attempt to restore, and make more explicit, the decision powers of the political leadership. The government was required to provide a better description of what it expected from an agency, and the budget horizon was prolonged. In return, agencies were given extensive freedom when deciding on the use of administrative allocations, but were simultaneously required to deliver improved reports and analyses of their achieved results.

In a separate but partially parallel chain of events, a new budget process based on the following main components was established in the mid-1990's (Molander 1999):

- ? An orthodox top-down process was implemented both in Parliament and the administration.
- ? A tri-annual expenditure ceiling, formally decided by Parliament, provided the basis for a longer time perspective in the budget process.
- ? Open-ended appropriations were abolished and replaced by flexible appropriations, which allow for a limited overrun at the appropriation level. The new system implies higher demands on the forecasting capacity of ministries and agencies, and calls for early warning signals to the political level in case overruns are foreseen.
- ? The rules that govern the budget process and that specify the delegation of financial power from parliament to government have been collected in a budget and fiscal management act.

The new budget process has recently been evaluated both by Parliament and by a government committee (Riksdagen 2000, SOU 2000:61). No substantial changes are foreseen. This budgeting system, together with the performance budgeting principle, can thus be considered as established, and will be a boundary condition for the discussion to follow.

1.2 Symptoms of malfunctioning

Even if Sweden may appear well positioned with respect to the development tendencies sketched in the previous section, comparisons across nations raise a number of questions. There is a range of concerns behind this inquiry that will be further detailed in the subsequent chapters. For now, we can note the following:

Staffing

Swedish central government employs close to 200 000 people, of which about 2500 or between 1 and 1.5 per cent worked in the Government Office (excluding overseas staff of the Ministry for Foreign Affairs). The agencification initiative in the UK has levelled off at 75 per cent, leaving around 25 per cent of the total staff working in the ministries. In fact one British agency (the Civil Service College) has been “re-ministerialised”. Is it efficient, as Sweden currently is trying to do (Forss 2000), to govern about 300 agencies using the equivalent of about 100 man-years?

Performance management in practice

Performance management requires a pro-active attitude on the part of the central authority. But short of staff, the Government Office runs into difficulties doing its part of the job in the Government/agency relationship. In a survey (ESV 1999), agencies have signalled that they do not encounter an equal partner in their exchange of information with the ministries. Does the Government Office shoulder its duties in the implementation of government policies?

Political accountability

In the relative vacuum that agencies often experience, some of them seem to make their own political judgements and have also developed their own strategic planning. Does this risk to blur the accountability of the respective parties?

Managerial authority

Devolving power and resources has a long tradition in Swedish governmental tradition. Municipalities or regional county councils, under the surveillance but not under the direct authority of central government, produce the bulk of social services – childcare, basic education, health care, and care for the elderly. Regional and local

savings associations that are autonomous legal personalities handle social security. This may again lead to a mismatch between power and accountability: Is managerial authority to implement political decisions at risk, and is political accountability jeopardised by the unclear division of responsibilities between central and local/regional levels?

Managing appropriations in the Government Office

In recent years, the Government Office has used an increasing share of its scarce time to the administration of appropriations, traditionally a task for agencies. Is this a threat to the constitutional rule on equal treatment of individuals and municipalities (Riksdagens Revisorer 2001)? Does it obscure the separation of duties between politicians and administrators?

Appointment of civil servants

Over the last three decades, an increasing percentage of senior administrators in the Government Office and the agencies have a political background as members of some political party, whereas the enrolment of the population at large in political parties is rapidly falling. One consequence may be to create a political/administrative elite with few links to the people that it works for. Is there a risk that the distinction between the political and administrative levels is blurred by the fact that individuals belonging to these categories sometimes change positions – politicians become senior civil servants and vice versa?

Early warning

The new central government budget process, formally in force since January 1st, 1997, requires alertness on the part of both ministries and agencies. One duty of the agencies is to provide the Government Office and ultimately ministers with indications of if, when and why budget projections turn wrong. In some notable cases, this has come to be neglected, and sizeable overruns have occurred without appropriate reactions, neither in the responsible agencies nor in the ministries. Is the

system incapable of detecting threats to the financial stability of important expenditure systems?

1.3 Previous work

The problems to be addressed in the present study belong to the category of eternal problems of governance, and have been the object of a number of inquiries during the 1980's and 1990's.

The Commission on Public Administration ('Förvaltningsutredningen')

A parliamentary committee chaired by Daniel Tarschys in the late 1970's (SOU 1983:39) analysed the autonomy that Sweden's administrative tradition assigns to the administration. It asked the question whether the political level has full control over the administrative apparatus, in particular in relation to the paragraph in the constitution (RF 11:7) that prohibits ministerial rule, that is, political interference in agency decisions concerning individuals or legal personalities.

The country's administrative tradition assigns considerable autonomy to the administration, and the debate has over and over again emphasised the value of independent agencies. On the other hand, any democratic system must ascertain appropriate political authority in the decision-making process. In order to make the government's responsibility towards the parliament – and indeed that of the parliament relative to the people – more than a formality, the government must be able to control the agencies to ascertain that appropriate action is taken when political decisions are to be implemented.

In the eyes of the committee, the government office makes only limited use of its authority. The committee found two reasons for this. First, neither parliament nor

government has the *capacity* that would be required for a more extensive intervention. Secondly, the political level does not seem to have the *ambition* to do so. As a result, officials, not politicians, may in effect take a significant number of policy decisions.

One reason for this situation was believed to be that important tasks have successively been transferred from political to administrative organs, without a proper analysis of the overall consequences for the functionality of the democratic system. Attempts have certainly been made to increase the control authority of political organs, but these efforts have not been adequate to compensate for the shift of balance in favour of the administrative sphere. Moreover, the authority to take decisions has often been handed over from one level to another without the construction of a system for monitoring and accountability enforcement. This has obscured the whole issue of accountability. As a consequence, the committee recommended that the controllability aspect should be upgraded.

Another conclusion concerns the government's formal mandate. The constitution is laconic both on the mandate of government vis-à-vis parliament, which tends to be a residual after parliamentary authority has been described, and on the relations between government and administration. By consequence, practice defines much of the relation both between parliament and government and between government and the agencies. An exception is the recent budget act, which has codified the financial freedom of action of government vis-à-vis parliament.

The Committee on governance of agencies ('Verksledningskommittén', SOU 1985:40)

The committee on agency governance focused on the internal workings of agencies, in particular the relationship between the director-general and the board of an agency. It analysed a few main alternatives mainly in the perspective of ensuring popular influence over administration. The relations between government and the agencies were also on the agenda – the committee agreed with the opinion that the government's room for

influencing agencies is substantial – but it also discussed other forms of channelling popular influence, such as layman representation in agency boards.

Consequences of membership to the European Union

Several committees (see SOU 1993:80 and Statskontoret 2000 for examples) have investigated the consequences of membership to the European Union for central government administration. Membership affects government office/agency relationships by increasing the administrative and analytical burden on the administration, sometimes rendering acute difficult questions on the division of labour between the two parties. The fundamental problem is how to establish working routines that ensure a sufficient degree of co-ordination in order that Sweden behaves consistently in various relevant forums. On the whole, these investigations have had a tendency to underestimate the administrative load and co-ordination problems that would follow from membership, underscoring the imbalances that form a central theme in the present report.

The Commission on Public Administration Policy ('Förvaltningspolitiska kommissionen')

The Commission on Public Administration Policy (SOU 1997:57, together with a number of background reports) carried out a very broad scanning of problems in the area of public administration – governance, control and audit, appointment policies, civil servant ethics etc. It is of course difficult to summarise the findings of so comprehensive an effort, but some of the main conclusions definitely go in the same direction as the discussion in the present report. Suffice it to mention general problems of governance, inadequate control of large resource flows (notably transfers), and a need for increased transparency in decision-making in general as well as concerning appointments.

ESO seminar on the Government Office

A seminar devoted to the problems of ruling with the focus on the Government Office was organised and reported in ESO (1998). Some of the diagnoses reflect the same

concerns as developed above (§1.2). The step from diagnosis to remedies is far from trivial, however, and a common element of policy discussions is to put forward single reform proposals without adequate consideration of the context in which the supposed reforms would take place. Creating a permanent, not politically appointed secretary – a frequent proposal in recent years – would be of little or no avail unless appointment procedures were simultaneously changed.

The Cost of Government ('Vad kostar det att regea?', Forss 2000)

The report by Forss analyses the Government Office from a number of different angles – size, tasks, efficiency etc. Some of the estimates will be used in the sequel. The main conclusions run in the same direction as the present study, although partly for different reasons.

Internal Government Office studies

The Government Office has produced a large number of internal studies. They concern a range of subjects relevant to the present discussion – supply of competence, personnel policy, the merging of the ministries into one single agency etc – and contain interesting base data. They will be referred to later in this report.

1.4 Our approach

One characteristic of modern societies is their far-reaching division of labour and responsibilities. The process towards specialisation is one of the main factors behind economic growth and welfare enhancement in a secular perspective, but is, at the same time, the source of numerous problems. As soon as one individual carries out a task for someone else, there is need for some sort of contract, tacit or explicit. But contracts must be specific enough to serve as a basis for mutual understanding; they need to be enforced; and so on.

The *principal-agent* (P/A) concept has been derived to understand the way in which private contractual relationships unfold, but it is increasingly used also to understand links between different parties within the public sector. The chain from voters to Parliament through government and the administration defines a chain of principal/agent relationships. It is the last link of this chain – that between government and the agencies – that is in focus in the present study. We do not believe that the P/A approach provides an all-encompassing picture of what takes place, neither in the private nor certainly in the public sector. The merits of the model, and in particular the generic presence of the two parties to the relationship – the principal/ministry and the agent/agency – will on the other hand provide us with a number of thoughts that may not otherwise have materialised. We present a skeleton version of the P/A model in chapter 3.

Two-party relationships of a more or less structured nature are of course nothing new. The need for cooperation is as old as humankind itself. But it is fair to say that the process of modernisation has brought with it an increasing tendency to formalise relationships that previously were guided by social relations of a non-formal nature. Indeed, Max Weber considered the transition from *Wertrationalität* (value rationality) to *Zweckrationalität* (instrumental rationality) as one of the pillars of modernisation.

And the process goes on. A basic argument of the present study is that ministries and agencies have long been linked by informal agreements that have spurred these interdependent institutions to deal with each other in a forthright manner; we will refer to these as relational contracts. For a number of reasons, some of which will be suggested in the rest of the report, this way to structure the relationship no longer works in the way it may have done in the hey-days of the system. The implicit contracts do not carry as much weight today as they once did.

Efforts to formalise the relationship along the lines of the performance management reforms of the late 1980s and early 1990s were an understandable and possibly

necessary first step of changes. But it was an inadequate response to the problems. The reforms did not consider the need to provide the Government Office with adequate means to guide the agencies that are nominally responsible to it: The need to replace the principal's weak interest in agency steering with a more proactive attitude was never put on the table. We also believe that the failure to systematically evaluate what has been accomplished is one of the greatest threats to durable innovation in public management (Schick 2000).

The report is in no way comprehensive. Rather, issues that may have been observed and discussed previously will be revisited but handled by putting on a specific pair of analytical spectacles. We reflect over governance and management problems through the lenses of the principal-agent paradigm, implying that our understanding of the relationship between two parties that try to get along will be tainted by this particular theory. It will therefore be necessary to outline our understanding of a contract – explicit or not – between two parties; to consider the consequences of that the two parties have access to differential information; and to assess problems caused by that the parties' respective objectives may differ.

Outline of the report

In chapter 2, we provide our picture of what has happened in Sweden's central government over the last few decades. Focus is on the question why symptoms of malfunctioning have appeared now. Are there any reasons in Sweden's recent administrative history behind the present discussions, or is the explanation to be sought among long-term trends? Chapter 3 delineates our frame of reference for the analysis to follow – some basic ideas of principal/agent theory and relational contracting. The following two chapters review the relationship between the Government Office and the agencies in some detail. Chapter 4 is devoted to staffing and organisation and chapter 5 to the formal aspects of governance (norms, budget, control and audit). Chapter 6 provides an in-depth discussion of the administrative reforms of the UK and New

Zealand. Chapter 7 pulls together the insights provided by the empirical review, while chapter 8 suggests policy conclusions.

Chapter 2 Stability and change in Swedish central government

2.1 From stability and homogeneity to disruption and fragmentation

If Swedish ministries and agencies have cooperated for so long, why is their relationship now being called into question? Is the current questioning of ministry-agency relations merely the intellectual whim of quizzical scholars who delight in challenging established ideas and practices, or have changes unfolded in the conduct and capacity of Swedish government that cast doubt on the small independent-agencies model?

A full consideration of these questions would require that we undertake a broad review of contemporary society and politics in Sweden to consider developments that may have affected the communication between the different parts of central government. Perhaps governance works best when the parties come from the same socio-political background, share the same view of government's role, and set the tone and content of public debate, and perhaps these features were more prevalent before than today. Perhaps the communication between the parties – often referred to as a dialogue – has been emptied of import by the weakening of consensus. Such trends have occurred in quite a few mature democracies, but they may have taken a bigger toll in Sweden because of the very size of government.

During the periods of rapid expansion of the public sector – roughly from 1960 to the late 1970's – Sweden enjoyed stable economic growth. During this period, persons who had a common outlook on the role of government cooperated in stretching the boundaries of the welfare state and conducted the dialogue between ministries and agencies. In annual budget negotiations – which are at the core of the government's dialogue – they discussed where incremental funds should be spent, which programs should be initiated or expanded, how much staff should be expanded, and so on. The dialogue was also carried on through *ad hoc* commissions established to deal with one

problem or another to recommend solutions, usually in the form of new programs. Hundreds of these consensus-building commissions were at work during the expansionary era, and their proposals typically led to legislation or other actions that expanded the scope of government. The dialogue generated little friction; commissions supplied the information needed to justify expansion, and annual budgets – fuelled by tax increases – supplied funds to pay for new or improved programs.

This expansion did *per se* imbalance the relationship between ministries and agencies. The latter became larger and more numerous, ministries hardly grew at all. There were more programs to monitor, and the paperwork burden on the government office escalated. Moreover, as government expanded the individual line items receded in importance, as did the input-oriented controls on agency operations. It became more important for ministries to know what had been accomplished with the money than to oversee the number of clerks on the payroll or the number of typewriters bought. But obtaining information on activities and accomplishments was much more difficult, and was more dependent on agency willingness to be forthright about what they were doing. This difficulty led to an anomalous relationship between ministries and agencies, which was aptly summed up in a 1985 report that made the case for the results-oriented reforms introduced later in the decade:

On the one hand, the Government has retained a great deal of its previous detailed control of State agency activities, especially in the field of personnel administration....on the other hand, the policy of expansion resulted in the *Riksdag* enacting legislation and the government issuing statutory instruments in many fields which are of such a general nature that extensive policy-making powers have in fact been transferred to state agencies.

A second important change affected the parliamentary landscape. In 1976, Sweden saw its first non-left-dominated government in 44 years. A partly implicit culture of understanding between the political leadership and the administration was suddenly put into question. The party picture, that had been extremely stable for a long time, broke up. New parties were born – the Christian Democrats, the Green Party, New Democracy – and government formation became increasingly difficult.

Traditionally, Sweden's policy makers and managerial leaders were social engineers who restlessly tinkered with organisations and activities while maintaining the prevailing policy orientation and government structure. As a consequence, Swedish government was always changing but did not change very much. At any time, dozens of reform commissions, many convened at the behest of *Riksdagen*, are at work, each expected to propose reforms that the government would then implement. The current number of *ad hoc* commissions is smaller than under expansionary days, and recent governments have decreed that committee proposals to increase public spending must also recommend balancing savings. The time frame for commission work has deliberately been shrunk, from several years to much briefer periods.

Commissions are consensus builders. Their membership may be drawn from elite, corporatist circles and often include legislators from both the governing party and the opposition as well as policy experts. Commissions usually circulate draft reports to affected parties and their recommendations rarely draw dissent. Most importantly, commissions built consensus by not questioning the basic principles and policies of Sweden's expansive state. They often do not build their results on a public debate but function as a forum for discussion between those invited. In this they are a prolongation of the central government's process of decision-making, the dialogue.

But with the turbulent 1980's, much of this changed. Within a tradition of consensus, commissions and working parties were suddenly asked to design important reform packages that were politically much more difficult to manage. From 1985 to 2000, approximately 100 agencies were reorganized or had their responsibilities adjusted. Further changes included:

- ? a major tax reform (1990-91),
- ? deregulation of the financial market (completed in 1988),

- ? an agricultural reform (1988-90),
- ? the dismantling of textile import quotas (1988; both of the latter had to be abandoned when Sweden joined the EU),
- ? deregulation of telecommunications and electricity markets,
- ? a major pension reform initialised in 1984 and completed in 2000,
- ? a major budget process reform (1992-96),
- ? and membership to the European Union.

But even with all these rearrangements, the way in which central government is run did not change much. The roles of the agencies and the relationship between the government office and the agencies were, on the whole, left untouched.

2.2 An unfinished reform

Sweden's performance management initiative was a product of its time. It was contemporaneous with reforms in other countries to redraw the relationship between policy and administration by withdrawing ministries from operational matters, refocusing them on performance and results, giving agencies discretion in managing their resources, and holding them accountable for meeting targets. Sweden's innovations had less to do with reducing the cost of government – thought that sentiment did emerge from time to time – than with getting the right policies and with improving performance. And reform was not entangled in big questions about the role or structure of government; it was propelled by confidence in the capacity of government to improve society by fine-tuning its programs and operations. This posture gave an optimistic, incremental tint to reform. Sweden's political-administrative culture is "...distinguished by a belief in the ability of government to deal successfully with the problems confronting society. This belief was not confined to the party or government ... but was rooted in the political establishment as a whole." (Furubo and Sandahl, 1993, p. 3.)

It is doubtful whether the reform would have happened if interaction between ministries and agencies were deemed to be satisfactory. Moreover, the perceived shortcomings of this reform – which is one point of departure of the present report – suggests the difficulty of formalising the ministry-agency dialogue by taking some matters that previously were disposed of in informal ways and putting them into formal documents.

The management reform was marked by considerable caution and phased in over three years after it had been carefully pilot-tested in approximately 20 agencies. The change was conceived in the mid 1980's, during an interlude in the fiscal crises that beset Sweden early in that decade and at the start of the next. It made no effort to alter the basic structure of government, but within this structure it sought to change the way ministries and agencies related to one another. The basic premise was that ministries should provide guidance on policy and expected performance while agencies should operate and spend available resources as they deemed appropriate. The dialogue between the parties would be reoriented from quibbling over spending items to discussing the results achieved in the past year or expected in the next. In effect, the budget was to become a contract for performance between ministries and agencies.

The reform established a 3-year budget cycle, though it retained annual estimates and appropriations. At the start of the cycle, each agency would conduct an in-depth assessment of its programs and operations pursuant to specific instructions provided by the ministry to which it was responsible. These instructions would specify evaluation criteria, performance objectives, the types of data and studies to be produced by the agency, and other matters relating to its programs. Following the assessment, the government and the agency would set a 3-year budget frame, indicating the amounts that would be made available to the agency in each of the next three years. These frames would set global limits on operating expenditures; they would not specify the amounts to be spent on salaries, accommodation, or other items. Each agency is therefore now free to allocate money on these items as it sees fit. Moreover, up to a certain ceiling

agencies are permitted to carry over unused operating funds from one year to the next, and under certain circumstances they are also permitted to borrow from the next year's budget.

The budget changes were intended to fundamentally change the dialogue between ministries and agencies. Rather than argue over operational issues, they would discuss the results achieved in the recent past and those planned for each of the next several years. For this reorientation to occur, however, it was necessary that ministries have the capacity and interest to instruct agencies on what was expected of them. In endorsing the new approach, the Finance Ministry counselled that the responsible ministry should avoid general directives that have little relevance to the agency's performance.

Underlying the technical revisions in the budget process was the expectation that the dialogue would deal with outputs rather than inputs and with big policy issues rather than with incremental adjustments in funding levels. Although the 3-year frames and managerial discretion covered only administrative expenditure, the Government hoped that the intensive reviews preceding and following the 3-year cycles would concentrate on objectives and performance. The Finance Ministry stressed in its instructions that "...the in-depth account shall cover the whole of the agency's activities regardless of how these are financed ... The results of activities are to be analysed in terms of resource utilisation performance and effects ... In the light of this analysis, the budget request shall propose the changes in the direction of the activity that are considered necessary and which should be submitted to the Government and Parliament."

(Supplementary Budget Bill 1988, p 8).

We have already established that the dialogue between ministries and agencies for long were conducted by persons who had a common outlook on the role of government and also cooperated in stretching the boundaries of the welfare state. In annual budget negotiations they discussed where incremental funds should be spent, which programs should be initiated or expanded, how many staff should be added, and so on. The dialogue was also carried on through the ad hoc commissions established to deal with

one or another problem, supplying the information needed to justify expansion, and annual budgets supplied funds to pay for new or improved programs.

The changes implemented by performance budgeting were intended to fundamentally change the dialogue between ministries and agencies. Although the 3-year frames and managerial discretion covered only administrative expenditure, the Government hoped that the intensive reviews preceding and following the 3-year cycles would concentrate on objectives and performance of programmes and activities at large. So the reform was prompted by gradual changes that over the years had tilted the balance between the parties, but – as will be further detailed in subsequent chapters – only part of the reform agenda proceeded according to blueprint: Agencies did obtain operating discretion, but the multi-year frames did not open the budget to a deeper dialogue on results.

For a profound reorientation to occur we believe that it is necessary that ministries have the capacity and interest to instruct agencies on what is expected of them. This is the big crux of the reform, the reason for that ministries have had difficulties in specifying objectives and what they expected by way of performance, and why agencies have had difficulty discussing results. Some problems had to do with start-up complications, but the most entrenched ones are rooted in shaky assumptions about how the two sides would behave once spending details were purged from the dialogue. The reform has, in fact, demonstrated that budgeting is a less pliant, more incremental process that does not readily promote far-reaching changes in programs or resources. The rest of the report attempts to explain this belief in greater detail.

Chapter 3. Principals and agents

Democratic government rests on popular consent. Parties or candidates get elected on the basis of programmes or specific promises. Governments are formed on the basis of election outcomes, and for a limited period the holders of power are allowed to use the instruments of government to implement their programmes. The government in turn depends on the administration, and eventually also on service producers, for the implementation of its policies. Many things can happen in this long chain from voters via parliament, government, administration and service producers. At each stage, someone – the *principal* – expects something to be done by someone else – the *agent*. For the sequence of delegations from principals to agents to work properly, the mandates given must be well specified, there must be reliable information about the outcome, and some feedback must be given in the form of rewards or sanctions.

Economic theory provides tools for understanding the relationship within central government. This chapter reviews some of these insights, starting with the generic relationship between policymaking and administration (3.1). We also describe the modelling of links between principal and agent (3.2), the problems that this relationship gives rise to (3.3) and their remedies (3.4). Much of the literature that analyses these issues is footed in private-sector experiences, but we also take some of the insights into the realm of the public sector (3.5).

3.1 The relationship between policy making and administration

Every democratic government must both connect and separate its political and administrative spheres. It must connect them so that managers and service providers fulfil the policies set by political leaders. No democracy can abide governing arrangements, which free administrators to disregard the policy preferences of duly selected leaders. But it also must disconnect administrative organs from direct political

control, so that they may act in an efficient, legal, even-handed manner: No democracy should allow politicians to intervene in administrative processes without regard to the rights and interests of those affected by such actions. The first criterion justifies the subordination of administrative organs to political leaders; the second dictates the independence of these entities. Striking the right balance between subordination and independence requires that politicians and administrators be both empowered and restrained. Each must have authority and resources to carry out its basic responsibilities, and each must be deterred from acting in ways that encroach on the other's work. The off-shot is a fuzzy and shifting boundary, which is continually being redefined through legislation and practice.

In drawing boundaries, a key issue is whether the greater concern should be to promote policy coherence or to protect administrative due process. Where the former predominates, government agencies are likely to be consolidated into functionally integrated ministries or departments corresponding to the main sectors of public policy. This leads to an administrative landscape with a small number of large departments for industrial policy, transport, social welfare, and other functions. But when administrative independence is deemed the paramount goal, activities tend to be dispersed among a large number of small, freestanding boards or agencies.

In most democratic countries, the prevailing arrangement during the 19th century was to separate politics and policy making from administration by establishing independent administrative entities to handle new governmental responsibilities. Although the doctrine of administrative due process was not yet well developed, it was widely accepted that government is more efficient when administration is walled off from political influence.¹ But as national governments expanded and added freestanding agencies, many were troubled by their overextended span of control, inadequate

¹ A classic formulation of the respective roles is the following; "...two primary or ultimate functions of government, viz, the expression of the will of the state and the execution of that will ... These functions are, respectively, Politics and Administration." Goodnow (1900), p. 22.

coordination, and lack of uniformity in administrative procedures. These concerns spawned an administrative counter-movement to merge the previously separate entities into functionally integrated departments. Functional integration was accompanied by other innovations to promote administrative efficiency, such as merit-based civil service systems, standardized accounting and budget practices, and uniform administrative procedures. Through most of the past century, the functionally integrated model became predominant.

Functional integration in public administration paralleled and was strongly influenced by vertical integration in business organizations. The latter internalises within the firm production and assembly of the various components that go into market products; the former internalises within departments the various activities contributing to the same objective. Once functional integration became the norm, governments habitually placed new activities within pre-existing departments. There have been exceptions, however, and it is a rare national government that has no agencies outside its departmental structure.

Functional integration dictates that policy makers and service providers be con-joined in the same department. In its heyday, the result was an elongated, hierarchical chain of command, widely regarded as an efficient means of coordinating activities by giving government a manageable span of control. Functional integration was thought to reduce administrative costs and friction, facilitate oversight by headquarters staff, reduce the number of officials reporting to political leaders, and promote uniformity in the provision of public services.

In functionally integrated departments, policy and administration are jointed yet separated. Often, top positions are reserved for political appointees, but the remainder is held by civil servants. Procedural rules that specify how civil service positions are to be filled, purchases made, and other administrative actions carried out are intended to create a politics-free public administration. The effectiveness of these rules depends as

much on behavioural norms as on legal constraints. Within a country's political-administrative culture, there are informal understandings of where the boundaries are drawn and how they are enforced, when and how politicians may intervene in administrative matters, how contact between the two spheres is maintained, and so on.

To obtain the expected benefits of functional integration, it does not suffice that politics and administration be separated; it is also necessary that they be linked. In blueprint, the relationship is supposed to work fluidly by having policy guidance and procedural rules flow downward, and information on activities and services flow upward. Policy makers would tell administrators what to do (and not to do) and would provide the financial and organizational resources to carry out assigned tasks, while administrators would report on what they have done and how they have complied with the policies and rules handed to them. Audits would verify the reliability of reported information and evaluations would assess the effectiveness of policies.

Actual relationships rarely conform to this textbook model, however. The relationship between politicians and administrators usually is more interdependent and less hierarchical. Administrators frequently advise on policy, and politicians often dictate how activities are to be administered.²

When this interaction is ongoing and close, it generates both cooperation and friction. In some settings, administrators and policymakers work side-by-side, without regard to status and formal roles. They fight on some matters and agree on others, and there are zones of indifference — matters on which some participants have a strong interest and

² Aberback et. al (1981) p 19 refer to this pattern as “the bureaucratization of politics and the politicization of bureaucracy.” In this comparative study of social policy development in Sweden and Britain, Hecló (1974) pp. 301-3 concluded that policy activism by civil servants is “a pervasive policy phenomenon rather than the exception. He found that “insofar as policy has evolved as a corrective to social conditions, civil servants have played a leading role in identifying these conditions and framing concrete alternative to deal with them.”

others do not — which enable the parties to co-exist in relative harmony.³ Formally, policy officials have the upper hand when interests collide; in fact, however, administrators may have the advantage because they can withhold or manipulate information on what they are doing to undermine or capture their political masters. Administrative agents can opportunistically serve their self-interest because they know much more about what they are doing and about the provision of services than political principals do.

Some governments seek to ease the principal-agent problem by placing senior civil servants at the top of the administrative hierarchy to broker the relationship with politicians. Depending on the country, these may be designated as permanent secretaries, vice ministers, director generals, or secretaries of state; they manage the information flow between the political and administrative realms. But these officials often have their own interests, which may be at variance with those of the persons they ostensibly serve. Many remain in their post for an extended period, and become adept at outlasting their principal's span of attention through "yes, minister" manoeuvres, outwardly displaying fidelity to their superiors while ignoring or deflecting the instructions they do not wish to carry out. Some, however, have been acculturated to serve and subordinate their own interests to those of their superiors.

3.2 The generic principal/agent relationship

A principal-agent (P/A) relationship refers to any situation where some party has an (explicit or implicit) arrangement with some other party saying that one is going to do something for the other. The two may be an employer and an employee, the shareholders of a firm and the firm's board, or the board and the Senior Executive Officer of the firm. Both parties to a P/A relationship may belong in the public sector. The relationship between the People – the voters in a country – and the country's

³ The term "Zone of indifference" is taken from Barnard (1938) pp. 168-9; Simon (1947) relabelled the term "zone of acceptance."

legislative assembly is one example. The legislative assembly has a P-A relationship with the government and the connection between the government and each of its agencies is yet another example of a P/A situation, indeed the association that we focus.

Our purpose here is to introduce some aspects of the principal-agent paradigm. We conclude that the problems are generic by nature. Coordination and motivation problems will occur irrespectively if units are functionally integrated or separated. The problems, and in particular their solutions, will, however, look different.

A fundamental observation about the economic world is that people can produce more if they co-operate, each specialising in their most productive fields of expertise. Adam Smith used the production of pins as the now classical example of how output increases when pin-workers specialise in different moments of pin-production. A higher level of consumption becomes feasible thanks to specialisation but to realise these benefits people must enter into transactions with one another to acquire the goods and services they desire but not produce. Most of these transactions are made over markets. Activities of the different specialists are coordinated by the price system and the specialists are also motivated by prices.

But even in a market economy, non-market activities are prominent. A firm is in fact something of an anomaly in that it replaces the market with non-price dealings between employees of the firm. Organisations can indeed be thought of as supplanting the market when they offer more efficient mechanisms to coordinate economic activities and to motivate people to carry out the resulting plans.

Bypassing the market by organising activities within firms eliminates neither the coordination nor the motivation problem. Rather, they are both transferred to organisational problems, since decisions and actions of specialised producers must now be aligned to each other in other ways than by way of prices to achieve the gains of co-operation. The organisation's motivation problem is to induce its staff to carry out their

parts of the co-operative activity. Both the existence of formal organisations and the specific details of their structures, policies and procedures reflect attempts to efficiently coordinate and motivate activities. The way in which a firm or a public organisation is structured, as well as their respective (business) strategy, may indeed be as important as technology, cost and demand in determining their success.

If there is a set of individuals or organisational units who have various decisions to make and actions to perform, a particular decision is decentralised if it is left to the individuals alone to make. In contrast, a centralised decision is one that is made at a higher level and communicated to or imposed on the individuals. The price system is fully decentralised, since each individual decide how much to offer for sale and how much to purchase. The typical public bureaucracy is an example of the opposite with a strict line of top-down command.

The decentralised organisation gives the right to take decisions to the most informed party. By definition, it is those who work with a certain task that typically know most about the particulars of that assignment, that are aware of the detailed trade-offs involved and the pro's and con's of alternative actions that can be taken. But full decentralisation would put us back to the archetype market again. And there are things that cannot be decentralised. The specification of an objective for an organisation is the obvious example, and drafting a strategy for achieving this objective may be another.

In complex organisational structures such as a nation's central government, neither complete decentralisation nor centralisation of all decisions is likely to be optimal. The problem is then to determine just what aspects of the overall decision ought to be left to the various individuals, what information should be communicated to assist individual decision makers, which parts of the decision should be centralised, who should make the centralised decision and what information sources they should use.

3.3 Problems in the principal/agent relationship...

Specialisation sometimes requires principal and agent to be organisationally separated. There must therefore be more or less formalised agreements to establish the links between the parties, understandings that recognise the nature of their interaction and that establish what line of action that should be taken by each in order to further their mutual interest. These understandings can be conceived of as contracts, regardless if they have the legal status of a contract or not.

Asymmetric information

A complete contract would take all eventualities into account. It would indicate what each party is supposed to do under any conceivable circumstance of importance to the agreement. After the contract has been signed, it is left to the agent to implement it. The principal is then no longer able to interfere. Any breach of contract may be brought to court, being the ultimate mechanism for settlement of dispute. Both parties are aware of this possibility. If the contract is not complete, a situation with moral hazard may arise if the following conditions obtain:

- ? There is some basis for gainful co-operation between the parties.
- ? There is some (potential) divergence of interests between them.
- ? It is not easy to determine whether the terms of the agreement have been followed.

Owners of a firm need a manager and the manager wants a position, and this generates the mutual interest to co-operate. On the second issue it is often assumed that owners of a firm want to maximise profits while the hired manager wants to ascertain a high salary while not working harder than 'necessary'. Both these behavioural assumptions imply that people – by and large – will do what they perceive to be in their own individual interests. In particular, the assumptions imply the possibility of divergent interests.

The problem of the owners is, third, that they cannot be certain about the origin of an exceptionally good (or bad) financial result of the organisation. Is it the result of the manager putting a lot of (very little) effort into his task, or is it the outcome of external events such as an unexpected upturn (downturn) in the business cycle? The manager knows more about this, but may have little or no reason to fully reveal the truth.

Moral hazard in contractual situations, which is an important example of an information asymmetry, means that it cannot be taken for granted that agents willingly do their part of the deal. They may report information to the principal that is favourable to further their own interest at the cost of the principal. Or they may undertake activities in other ways than what would, in principle, be feasible. The agents are able to do so since they are better informed than the principal. The motivation problem is to overcome this asymmetry.

In the private sector, moral hazard problems are tackled by contractual constructions.¹ In this, it is recognised that what can actually be accomplished is constrained by individuals self-interested behaviour, meaning that incentives of the individuals must be aligned as far as possible to the goals of the organisation that they are serving. This will reduce the cost of moral hazard but will never eliminate the problem as such.

Incomplete contracts

Contracts are intended to solve potential conflicts of interest by aligning incentives. But in real life, no complete contracts can be formulated. People therefore design contracts recognising that the agreements cannot be perfectly adapted to all possible future circumstances. This adds further dimensions to the need to coordinate and motivate the parties.

¹ The moral hazard concept originates in the insurance industry where the insured must be induced to take "appropriate action" in order to prevent damage to occur. To this end, the insurance contract include different types of excess clauses.

Even relatively simple contracts can be subject to problems and disputes. The most commercially important impacts of imperfect commitment however arise when significant investments are required. This is so both because investment-costs and -benefits often are large and since the benefits may accrue over an extended period of time. And the kinds of investments that are most problematic in terms of the incentives they create are investments in specific assets, that is assets that are most valuable in one specific setting or relationship.

Given the unavoidable incompleteness of contracts, the alignment of interests can only be imperfect. Concern with the possibility of being disadvantaged by self-interested behaviour that an incomplete contract does not adequately control for may limit the extent of co-operation that can be achieved. If, for instance, a contract presumes investments on the part of the agent, the principal may be able exploit this fact once the investments have been made. Realising this risk may deter the agent from investing optimally. The so-called *hold-up problem* means that a party that is forced to accept a worsening of the effective terms of the relationship, once it has sunk an investment with poor opportunity use, has been held up. This would not be so if the parties could write complete contracts that regulated what would happen if one party reneged on the deal.

Insufficient commitment to a deal materialises if one side or the other tries to renege on the deal, for instance by not paying for services rendered or not delivering goods that have been contracted for. This general contractual problem is intensified with incomplete contracts, since what should be done in various circumstances is left open or formulated in an ambiguous way, thereby making it feasible to make different interpretations. It may for instance be possible to claim that what you do today is what was originally agreed, in reality, and that no renegeing is going on at all.

A second consequence of the commitment problem is referred to as *ex post* renegotiation. In some circumstances it may actually be advantageous for both parties to renegotiate the contract because what was a clever deal when the contract was first

drafted and signed may not be so once actions have been taken or further information revealed. If the parties understand at the time they are crafting the original agreement that they may later face this situation, they may in the first place be unable to draft the contract in a way that generates the desired behaviour. It is then the anticipated risk for renegotiation that is the problem.

Problems of measurement

In an often-quoted paper, Bengt Holmström and Paul Milgrom (1991) study what goes on when a firm produce more than one product at a time. The generic multi-task problem is dealt with under the assumption that not all outputs, taken in its broadest sense, can be measured with equal accuracy. Even in relatively simple production lines, for instance, numbers are much easier to measure than quality. An overemphasis on easily measurable dimensions will then distort the incentives of the agent and lead to non-optimal behaviour. The general conclusion is that when some outputs are difficult to measure, less weight should be assigned to the output of the variables that can actually be measured when rewarding the effort. Professors that "produce" research and teach students should, for instance, not be remunerated only according to what is relatively easy to measure (the number of published papers), precisely because it is difficult to measure the outcome of the other activity (teaching).

In a later paper, Holmström and Milgrom (1994) discuss the implications for organisational design of this result. The message is that P/A relationships based on outsourcing and contracts should be expected when outputs are relatively easy to monitor, whereas in-house production by employees should be expected in the reverse case. It is easier for an owner to monitor the effort of his own employees. In particular, it is feasible to control input – the number of hours devoted to a task – as a form of second-best solution to the problem of motivating staff to produce at their very best. An organisation's incentive structure may therefore in some situations require the elimination or muting of incentives that in other, more market-near relationships would be more appropriate.

Low-powered incentives imply that an agent receives a small fraction of his or her marginal product. The use of low-powered incentives within a firm is sometimes lamented as one of the major disadvantages of internal organisation. But it is also an important vehicle for inspiring cooperation and coordination in the Holmström & Milgrom model of firms with multiple, non-measurable tasks; higher-powered incentives would induce agents to put more effort into tasks that are highly rewarded at the cost of activities that are beneficial for the organisation at a whole but that cannot be measured.

They also show how the effectiveness of low-powered incentives within the firm may be further enhanced by simultaneously placing constraints on the employee's freedom to act. Like low-powered incentives, bureaucratic constraints have frequently come under attack as being costly and inefficient. It is notable that the sort of criticism we hear today – that bureaucracy impedes innovation, that it is hopelessly slow, that it limits communication, that it prevents personal growth, and so on – are all problems that have been with bureaucracy from its inception. The natural economic hypothesis is that these bureaucratic constraints actually serve a purpose, namely to reduce the risk that bureaucrats focus on tasks that can be measured at the cost of less measurable activities. To the extent that there is a need for reduced bureaucracy today, it may be because the environment has changed, for instance since the technologies to monitor and follow up on output has improved.

3.4 ... and their remedies

Peer groups

Let us consider a private sector firm with several shareholders. The owners can be assumed to want maximum return from their stock and shares may be marketable. A

shareholder may therefore transfer her property rights to another investor and thereby terminate the relationship with the company. Changes in the number of principals and in the distribution of shareholdings can therefore occur quite rapidly. The pursuit of its own objectives by the management of a private firm is therefore constrained by three groups of participants in capital markets (cf. Vickers & Yarrow 1989, ch. 2):

- ? The firm's shareholders, seeking contractual arrangements with management that maximise their own payoffs;
- ? other investors or their agents (e.g. managers of other companies), who might purchase the firm's shares as a prelude to attempting to alter existing contractual arrangements; and
- ? the firm's creditors who could seek managerial changes in the event of threatened or actual default.

A private firm is in this way faced with outside interests that each has its own reason to scrutinise performance. A manager who strives 'too far' away from a strategy which would best contribute to shareholder value always run the risk of being corrected, often in brutal ways. There are a number of practical ways in which the peer groups work, the most important perhaps being the highly formalised auditing of the books of public companies. Formalisation is basically a way to ascertain that certain rules are followed, for instance with respect to valuation of assets, and that information about crucial dimensions of managing a firm is made available to all interested parties. The rules get even more formalised when companies are registered at the stock market exchange, where there are strict rules to ascertain the timing and quality of information given to the market. There are also rules on insider activities, without which some actors on the financial markets might get access to information in advance and use it to their own benefit, at the cost of others.

Contractual controls

The generic P/A-problem emanates from the lack or asymmetry of information. When one firm strikes a deal with another, one way to handle the asymmetry is to be *as specific as possible* concerning the obligations of the parties involved, in order to generate mutually consistent expectations. Even if contracts are and will be incomplete, it is strong reason to be as precise as possible in the description of the respective duties. In particular it should be in the principal's interest to assign relative weights to the activities of an agent with multiple assignments.

A second remedy is to *monitor* in order to narrow the gap of information. The more resources spent on controlling what is going on, the more difficult it is for agents to deviate from what their principal want them to do. But monitoring requires the peer to be informed about the activity that is scrutinised. An ill-informed principal would not know what to look for or what a signal indicating that something is wrong would look like.

Monitoring does not come for free, neither in the development of monitoring systems nor in their use. Even if it would be feasible, in principle, to eliminate the information asymmetry gap with sophisticated monitoring techniques it is not optimal, simply because the gains from increased availability of information would not be sufficient to outweigh the costs for generating this information. Random control is then a way to discipline agents by introducing a risk for being examined.

The third component of a well-designed P/A-relationship is a system for holding the agent *accountable*. Rewards and sanctions foster the desired behaviour. Such instruments must be predictable, tailored to the situation, and possess a reasonable degree of legitimacy. Again, this is no easy task. Sanctions are supposed to function preventively, but enforcing a sanction once the contract has been broken may be a costly affair. Not enforcing it would, on the other hand, eliminate the disciplining power of the sanction.

Less formalised institutions

The hazards of contractual situations can be dealt with in the above more or less formalised ways. Equally important may be the implicit checks and balances that the parties to P/A relationships over the years have come to develop under the understanding that the benefits of specialisation could not be reaped less they both behave reasonably well.

In complex transactions or relationships that extend over time, the parties may not agree on detailed plans of action but on goals and objectives, on general provisions that are broadly applicable. Other solutions may include the decision about criteria to use when unforeseen contingencies arise, on who has what power to act and the bounds limiting the range of actions that can be taken and of dispute resolution mechanisms to be used if disagreements do occur. So, in situations where reasonably complete contracts are too costly or impossible to draw up, actual contracts may be *relational*, serving to structure a relationship and to set common expectations. We believe that this provides an important clue to the way in which central government operates and will return to the concept of relational contracting in chapter 7.²

Implicit but shared expectations that the parties have concerning the relationship as an adjunct to incomplete written contracts is another remedy. Corporate culture – interpreted to be a shared set of values, ways of thinking and beliefs about how things should be done – can be one aspect of an implicit contract.

The risk of being held up explains why *commitment* is particularly important in situations with incomplete contracts. If one party is known to stick to an agreement, even if it in the short run would be beneficial to deviate, it may affect the other party's expectations about this behaviour and thereby his or her own behaviour. The concern

² The idea of relational contracting is explored in Macneil (1974) Macneil (1978).

with reputation may be a way to overcome the temptation to renege or renegotiate. In a world of costly and incomplete contracting, trust may in fact be crucial to realising many transactions. The effectiveness of trust is related to the frequency of similar transactions, the horizon over which similar transactions are expected to occur and the transaction's profitability. The incentive to build and maintain a reputation is larger the more frequent the transactions, the longer the horizon, and the more profitable the transactions.

3.5 The principal/agent problems of government

The chain from voters via members to parliament and government to administration in important ways represent a series of principal/agent problems. The fact that there are analogies to be drawn between the public and the private sector is not meant to imply that the problems are identical. In fact, there are several important differences. One refers to the multidimensionality of goals. While profit maximisation may be an acceptable first proxy behavioural assumption for the owners of private firms, the presence of multiple goals formulated by a government for its agencies is commonplace. Moreover, the fulfilment of public-sector objectives are often difficult to measure.

Another difference is that the ultimate "shareholders" of public-sector entities are the people. Mere numbers indicate that the people have more heterogeneous tastes than ordinary shareholders (although the latter will normally also differ). Tastes and public-sector objectives may also change over time more than the objective of private owners.

We have seen that private-sector firms may use incentive contracts to discipline agents. 'Good' outcomes are then better awarded than 'bad', irrespective of if the favourable outcome is the result of a good performance of the manager or luck. An incentive contract is simply a means to increase the chance that a 'good' result will materialise.

But the public sector is notorious for its low-powered formal incentives, meaning that the agent receives only a small fraction of his or her marginal product. One reason is the difficulty to measure the performance of officials. The tension between measurable and non-measurable objectives may be an important explanation of why we see this difference between the two sectors across the world. As demonstrated in the Holmström & Milgrom model quoted above, similar, while possibly less severe, bureaucracy problems will occur also within (large) private corporations.

In the absence of financial incentive mechanisms, the concerns for the future *career* of officials may be an important although implicit incentive-shaping mechanism, even more so in the public than in the private sector. Civil servants are concerned by the effect of their current performance not primarily for their immediate monetary reward but more so for their reputation or image. This is what will affect the prospects of future promotions and the chances to acquire jobs in the private or public sectors. Politicians may be guided by a similar concern to be re-elected.

Holmström (1982) identifies four conditions that need to be at hand for career concerns to function as an effective incentive mechanism. First, job performance should be visible by those who grant promotions and wage increases. Second, current performance should be informative about the official's ability in future tasks. Third, the official should be forward-looking and not discount the future too much. And fourth, signalling – sending information that is relevant to convince the peer that the agent is a good performer – should not be too costly to the official.

Another difference between the private and the public sector is that the position of peer groups differs. We have seen that the firm's manager is hunted down both by owners, creditors and potential threats of (hostile) take-overs. Public sector auditing controls the senior officials of the agencies. Audit results are communicated to parliament (or the government), which in turn bases its power on the public franchise. Given that an

agency in this perspective is just the executive arm of a country's executive branch of the Parliament, its performance can be put in question only at the election date. It is the public franchise that is the ultimate pressure on both ministry and agency to produce services in an appropriate way.

The public franchise as an accountability enforcement mechanism is problematic because of the time-gap between elections. It is also a problem that a vote of no confidence includes many dimensions of performance. In particular, a government may deliver services of high standard in many dimensions except for what is delivered by one particular agency. Voters will in such cases be reluctant to punish the politicians by voting for the opposition. The public franchise is therefore at best a blunt and indirect tool for controlling central government agencies.

Yet another difference between the two sectors is the relative position of customers. Most buyers of private sector goods and services have a choice. Losing customers to competing suppliers may therefore punish a manager who supplies services of inferior quality. By contrast, most public sector agencies are the sole producers of the particular service they are set up to deliver.

The government-to-administration principal/agent game

In spite of these differences, the principal/agent framework offers a fruitful perspective on the problems also of public sector governance. The relationship in focus in the present report – that between central government politicians and the administration – is perhaps the link in the chain between voters and final output that comes closest to a ‘standard’ P/A relationship.

For large organisations such as a country's central government, one and the same individual is obviously not capable to take on duties in the same way as a local politician in the old days used to. The single most important reason is the high degree of specialisation. The larger the organisation, the more difficult it is to obtain information

of relevance for making decisions. Organisational design gets increasingly difficult, but also increasingly more important.

Our short review has indicated that all three major components of the P/A relationship – contracts, monitoring, and enforcement – imply formidable problems for the political level. How far should the contract between principal and agent be formalised? To what extent can the performance of civil servants be measured? What is the appropriate repertoire of rewards and sanctions? Let us just indicate how a few of the fundamental choices of public administration design tie to the P/A framework.

The difficulties both of measuring the output of public services and of separating the effort of a civil servant from the background noise directly affect the choice between an external contract-based relationship – the agency – and in-house, ministry-based solutions. One should expect the agency-based solution to work best where output is relatively easy to measure. Further, in a country such as Sweden, where the agency-based model dominates the scene, one should expect *ad hoc* decisions in situations where this model could be expected to work less well. Examples would be to resort to corporatist solutions – appointing representatives of various interest groups to the board of an agency – or to use informal instructions as a means of communication, when goals are difficult to formalise.

Rewards to agents will in this environment seldom be economic, but rather tied to career paths. Medium-level civil servants are promoted upwards in the hierarchy, and directors-general can be confided with larger or more important agencies. Sanctions are on the whole difficult to design and will most often take the form of no-reward. Depositing an official, not to mention the director-general, is a politically costly decision.

Authority is the defining feature of hierarchy. The boss can restrict the subordinate's actions, overturn his decisions and in principle fire him (unless the boss's boss objects, in which case the boss herself may be fired). Tracing this chain of authority up the

hierarchy, we eventually reach a person (the senior civil servant) or group (the government) who can be thought of as owning all the decisions rights in the organization. In short, formal authority resides at the top.

Of course, tyrants who actively exercise their ownership of all the decision rights in the hierarchy, run few organizations. To the contrary, many middle managers wield substantial authority. But such authority is typically informal in the sense that it can be retracted by those higher up the hierarchy, ultimately by those at the top who hold the formal authority. That is, all subordinates' decision rights are loaned, not owned.

Given that formal authority resides at the top of organizations, when and how will bosses delegate informal authority to subordinates? One conclusion of modeling this problem (cf. Baker et. al 1999) is that subordinates frequently face the opportunity to abuse their authority (for instance by using an expense account for unauthorized expenditures) but opt not to, because such abuse would lead to the retraction of authority in the future. This model would then capture the tension felt by subordinates in exercising their authority "responsibly". The Swedish system of governance has preponderantly been one of responsibility rather than accountability. A correspondingly "soft" system would not function in a more corruption-prone environment

It is still feasible to make the agent accountable for precise objectives by pinpointing them in a contract that also formalises the way that they will be monitored. But, as demonstrated in the Holmström-Milgrom model, this generates great risks that he or she does not take possible other objectives into account. This is the problem of measurement. Experience from New Zealand, to be reported in chapter 6 below, will demonstrate that this is not merely a hypothetical problem.

Accountability is a widely used concept in the discussion of how responsibilities are to be assessed, not dealt with so far in our review. Maskin & Tirole (2001) eloquently establish how this concept can be incorporated into the framework of the P/A model.

They for instance establish that the more technical that decisions get to be, the more ill-suited are they to be handled in a political process; such decisions should largely be confined to the agencies. It would otherwise be difficult for a relatively ignorant electorate to hold politicians directly to account for complicated issues.

Internal P/A dilemmas

In the particular perspective chosen here, the institutions of central government can be said to define the major principal-agent problems to be solved. Indeed, drawing the boundary between ministries and agencies as it has been done for centuries in Sweden quite naturally yields the relationship between ministry and agency as the main principal-agent problem, to be handled by formal contracts, rules and routines. But there remain P/A-type problems *within* the ministries and *within* the agencies, whose character and format depend on how the interface between ministries and agencies are defined. Suppose that the political leadership of a ministry is dissatisfied with its control of an agency and intends to strengthen it. This can be done by strengthening the capacity for analysis and evaluation either at the ministry or at the agency level. A third alternative is to create an autonomous unit outside both the ministry and the agency (for examples, see chapter 5). Assuming that the choice is between the first two alternatives, it must be recognised that defining a contractual relationship between the political leadership and such an analysis group is extremely difficult. Principal/agent theory would tell us that an *in-house* solution would be the preferred alternative; the analyst capacity must be integrated into the ministry bureaucracy for the leadership to feel confident that it serves the purpose intended.

Chapter 4 Staffing and Organising Central Government

The execution of public power in Sweden rests on five pillars. The classical power to issue *norms* (“föreskriftsmakten”) is exercised by way of law, ordinance or other formal provisions. Second, parliament may prescribe a particular mode of *organisation* in order to elicit desired forms of behaviour. Third, the power to *finance* (“finansmakten”) is exercised mainly via the state budget. Fourth, the power of *appointment* (“utnämningmakten”) gives the government influence over the recruitment of high-level civil servants under restrictions laid down in the constitution. Fifth and finally, the power of *audit and evaluation* (“kontrollmakten”) presumes monitoring, evaluation, reviews, and formal audit.

The first two sections of this chapter establish which human resources that are at the disposal of the Government Office (GO) and the three agencies selected for the case studies (4.2). We then discuss the government’s recruitment and appointment policies (4.3) in order to address the issue of staffing imbalances (4.4). The more general issue of organising activities is addressed in section 4.5. Norms, budget and control issues are treated in the following chapter.

4.1 The Government Office

Staffing

The staff of an organisation is its basic resource. Organisational structures, the budget process and other regulations are abstract rules whose implementation to a considerable extent is determined by the people to be governed by these rules. Numbers, incentives, career paths and similar aspects of the central government administration are needed to understand the process of policy-making, its achievements and deficiencies.

Table 4.1 provides data on the long-term trend of GO staffing. Between 1978 and 1999 the number of employees (exclusive of committees) has increased by some 15%. During the same period, the total number of state employees has decreased, one reason being that state companies have been sold to the private sector. Some previously state-owned companies operating under other a different judicial framework than private companies (*affärsverk*), have furthermore been corporatised while not privatised, or only partly so. Examples include what used to be state agencies for telecom and postal services, both that now operate under the same legal rules as any private corporation.

Year	Ministries	Committees	Total	Total number of state employees
1978	3 274	570	3 844	423 000
1980	3 478	627	4 105	429 000
1986	3 520	272	3 792	424 000
1990	3 484	233	3 717	401 000
1996	3 783	312	4 095	260 000
1999	3 773	297	4 070	240 000

Table 4.1. Number of GO employees from 1970 to 1999. *Sources:* Ministries and Committees: Statskontoret (1997); State employees: Statistics Sweden.

On average, 7 per cent of the Government Office's employees work for committees (cf. also Table 4.2). While a Ministry formally employs them, these individuals are not available for everyday activities. A substantial proportion of this staff have their ordinary position with an agency, typically that agency which is in charge of matters being examined by the committee they belong to. Table 4.2 also demonstrates that between 4 and 6 of the GO staff are assigned on political merits and would consequently be replaced if an election results in change of majority.

Leaving out support staff and the foreign office administration, around 2200 man-years are available in the GO. The total number of employees in central government is 191 000 (1998; Swedish Agency for Public Management 1999) and in state-owned companies well above 100 000. Even if so-called staff agencies (Statskontoret, ESV, SIKÅ, IFAU and others) would be included, this does not alter the picture of a

government office that is small in comparison to the administrative body that it is expected to govern.

	Justice (%)	Social affairs (%)	Industry (%)	Total (%)
Political positions (minister, state secretary)	4 (2)	5 (2)	7 (2)	54 (1)
Other political assignments*	5 (2)	10 (4)	12 (4)	109 (3)
Experts**	14 (6)	20 (9)	10 (3)	99 (2)
Senior advisers	25 (10)	8 (3)	34 (10)	390 (10)
Employed as DG at the Chancery	3 (1)	0 (0)	0 (0)	11 (0)
‘Legal adviser’ (rättssakkunnig)	49 (20)	11 (5)	15 (4)	156 (4)
Employed on ‘standard’ contract	95 (38)	103 (45)	199 (56)	2461 (60)
Other	8 (3)	15 (6)	24 (7)	493 (12)
* Subtotal	203 (82)	172 (74)	301 (85)	3773 (93)
Committees				
- no central government employment	6 (2)	24 (10)	25 (7)	98 (2)
- ministry employee	0 (0)	1 (0)	3 (1)	25 (1)
- legal expert (rättssakkunnig)	25 (10)	12 (5)	4 (1)	68 (2)
- other central government employee	12 (5)	22 (10)	18 (5)	106 (3)
	248	231	355	4070

* Assignments with time limits given by general elections.

** People with special competence having time-limited assignments (*ämnessakkunniga*).

Table 4.2: Number of employees with different classes of employment contracts. Source: The GO's administrative department.

An overwhelming majority of the GO's civil servants have a university degree. Between 1 and 3 percent have research training, i.e. licentiate or Ph.D. degrees. The ratio of PhD's is still low, the Ministry of Finance having the highest figure (Table 4.3).

	Justice (%)	Social affairs (%)	Industry (%)	Total Chancery (%)
Up to 12 years and not known	64 (26)	112 (48)	126 (35)	1913 (47)
University degree	181 (73)	114 (49)	219 (62)	2047 (50)
Research degree	3 (1)	5 (2)	10 (3)	110 (3)
Total	248	231	355	4070

Table 4.3: Number of GO employees with different educational background. Source: The GO's administrative department.

Activities

Government office activities can be divided into the following main categories:

Legislation: The elaboration of legislative proposals accounts for a large part of the time available for GO staff. During the 1990's, the number of bills presented annually decreased by about 15 per cent, but the number of remittals to the Parliamentary Council of Legal Advisors (*lagrådsremisser*) has increased (GO annual reports). The total output per employee engaged in the activity has risen over time in quantitative terms. At the same time there has been some concern over the quality of the proposals (ESO 1998a).

Budgeting and management: Major outflows of the budget and management areas are the budget proposal and the issue letters that define the tasks and set the budget limits of each agency. The total amount of time spent on agency management has been estimated to 110 man-years per year (Forss 2000, ch. 6), which corresponds to about 70 man-days spent on the average agency. In other words, about 5 per cent of the total labour input in the ministries is devoted to agency management.

The net value of total assets of state-owned companies is 124 billion SEK (as of December 31st 1999; ESV 2000). About 30 man-years are spent annually on management of these enterprises (Forss op. cit.). Government representatives in the boards of state-owned corporations are normally picked among state secretaries and under-secretaries. The system has been criticised on the grounds that, in a sense, it makes these representatives responsible to themselves.

Administrative decisions: The number of decisions (currently 10 000 per year; Forss op. cit.) has been cut by half during the 90's and by a factor 4 since the 1960's by delegating decisions authority to the agency level. Some attempts to delegate have been less successful because of the political character of the issues; decisions on individual applications for political asylum are a case in point. But largely speaking, the process of delegation has been successful and has reduced the ministries' workload significantly.

International cooperation: EU membership has increased the amount of time spent on international issues substantially. According to the ministries' own estimates, close to 40 per cent of civil servants' time is spent on EU related issues (Forss op. cit.), but this fraction varies a lot between ministries – agriculture and defence representing the extremes. In concrete terms, internationally related work consists in participation in expert committees, negotiations, implementation committees, translation and adaptation of the *acquis communautaire*, and general inquiries pertaining to international involvement. Also the agencies are deeply involved in EU related work. About half of the ministries consider the division of labour between the ministry and its agencies to be inadequate. The ministry is too small to be able to fulfil its tasks and has to rely upon the agencies to an extent that is not considered satisfactory (survey by Swedish Agency for Public Management, reported in Forss 2000).

Except for EU related tasks, Sweden is a member to 2900 international organisations. Again, the necessary time involvement depends both on the organisation and the level of ambition.

Outreach: Answering questions from MP's and responding to letters from the public accounts for another sizeable fraction of the staff's time. The number of formal questions in parliament has risen by 60 per cent during the 1990's. This development is the result of a conscious effort to activate the relationship between parliament and government and to give parliament a more prominent role in public policy making.

Administration of appropriations: A noticeable change that has taken place over the last few years is the more active involvement in policy implementation on the part of the government. The GO currently manages 15 to 20 billion SEK or 2 to 3 per cent of the state budget for various purposes, often with a regional or local dimension. Whereas this task probably does not detract substantial staff resources from the small pool available, the handling of appropriations in the ministries gives rise to a number of both

administrative and principal problems. Routines are not well developed, there is no complaint procedure when the government is the decision-maker, there is no evaluation coupled to the appropriations, etc. (RRV 1998; Riksdagens Revisorer 2001).

Internal services: IT support has grown rapidly in recent years. IT outlays per employee are somewhat lower than in comparable public organisations in Sweden but higher than in the cabinet offices of neighbouring Nordic countries. There is no clear indication that the offices are lagging in the development of IT support.

4.2 Agencies versus ministries: Three examples

The three ministries and agencies singled out for a more detailed study were chosen in order to illustrate the wide variety of activities that a modern state is involved in – the classical night-watch state (Ministry of Justice and the courts), responsibility for infrastructure (Ministry of Industry and the National Road Administration), and the welfare state (Ministry for Social Affairs and the National Social Insurance Board).

Central Government Management of Courts

The Ministry of Justice has some 200 employees (Table 4.2 above). The Ministry *inter alia* controls the agencies enumerated in Table 4.4.

The Division for Procedural Law and Court Issues is one out of the Ministry's 14 divisions. It has about 20 employees. Besides courts this division also is responsible for the Chancellor of Justice, the Swedish Gene Technology Advisory Board, the Supervisory Board of Public Accountants, the Regional Tenancies Tribunals and the Regional Rent Tribunals. Moreover, it is in charge of much of the legislative work relating to procedural law, procedures in the public courts and in the public administrative courts.

Name (English)	Name (Swedish)	No. of employees	Allocations, mill. SEK
The National Courts Administration	Domstolsverket/domstolar	5.105	3.962
The Prosecution Authority	Åklagarväsendet	1.200	621
The National Police Authority	Rikspolisstyrelsen/lok.	22.000	11.400
Swedish Prison and Probation Service	Kriminalvården	7.800	4.000
Office of the Chancellor of Justice	Justitiekanslern	16*	23*
National Council for Crime Prevention	Brottsförebyggande rådet	60	39
Criminal Victim Compensation and Support Authority	Brottsoffermyndigheten	26	11
Swedish Gene Technology Advisory Board	Gentekniknämnden	30	3
Data Inspection Board	Datainspektionen	157	24
Legal, Financial and Administrative Services Agency	Kammarkollegiet	44	26
Swedish Agency for Administrative Development	Statskontoret	119	177
Statistics Sweden	Statistiska centralbyrån	1.300	368
National Government Employee Pensions Board	Statens pensionsverk	300	1

*Table 4.4: Assorted agencies sorting under the Ministry of Justice. Number of employees and total appropriations (excluding charges for services) for 1998 or 1999. Source: ESV (1999) and homepages. * Numbers for 2001.*

The Swedish National Courts Administration (*Domstolsverket* or DV for short) is the central administrative authority for courts. DV is therefore an agent relative to the Ministry of Justice and the (administrative) principal of the courts. The agency shall, within its area of competence, manage and co-ordinate the administrative duties of public courts, pass instructions and give common advice to the courts and ascertain that their activities are undertaken in an efficient way. In this, DV must observe the constitutional independence of courts when these perform their adjudicating and law application duties. The agency may, for instance, not prescribe that a certain case is allocated to a certain judge (SFS 1988:317).

In 1999 the government allocated some SEK 3 billion to courts. One of DV's duties is to allocate these appropriations across the judicial system's component parts. Civil courts make up one part of the system, comprising three tiers; 96 district courts, six courts of appeal, and the Supreme Court. The common administrative courts comprise the system's other part with 23 county administrative courts, 4 administrative courts of appeal and the Supreme Administrative Court. During 1998 the system operating under the auspices of DV had 5 600 employees, 134 at DV's main office.

Central government management of social security

The Ministry for Social Affairs (*Socialdepartementet*) has some 170 employees (cf. Table 4.2), excluding committee staff. It is the principal of 27 agencies. Table 4.5 lists the larger of these, their respective appropriation and the total number of employees by the end of the 1990's. Besides agencies that obviously should be under the auspices of this ministry, the list includes *Systembolaget* and *Apoteket*, the monopolist providers of alcohol and drugs, respectively.

Name in Swedish	Name in English	Appropriation, mill. SEK	No. of employees
Alkoholinspektionen	National Alcohol Board	14,5	15
Apoteket AB**		23,4**	10 000
Barnombudsmannen	The Children's Ombudsman	9	12
Folkhälsoinstitutet	The National Institute of Public Health	160	90
Hjälpmiddelsinstitutet	The Swedish Handicap Institute	45	83
Handikappombudsmannen	Office of the Swedish Disability Ombudsmen	19	8
Hälso- och sjukvårdens ansvarsnämnd	Medical Responsibility Board	21	n.a.
Läkemedelsverket	Medical Products Agency	171	230
Premiepensionsmyndigheten	Premium Pension Authority	New	new
Rättsmedicinalverket	National Board of Forensic Medicine	172	370
Socialstyrelsen	National Board of Health and Welfare	364	496
Socialvetenskapliga forskningsrådet	Swedish Council for Social Research	9	8
Statens beredning för utvärdering av medicinsk metodik	Swedish Council on Technology Assessment in Health Care	20	35
Statens institut för särskilt utbildningsstöd	Swedish National Attendant's Service	10	15
Statens institutionsstyrelse	National Board of Institution Care	485	60/2600
Statens nämnd för internationella adoptionsfrågor	National Board for Intercountry Adoptions	4	10
Systembolaget AB**		19200	1300

*Table 4.5: Agencies with Ministry of Social Affairs as principal. Source: ESV (1999) and homepages. *1999, ** Publicly owned corporation with statutory monopoly. The number refers to turnover.*

The *National Social Insurance Board* (*Riksförsäkringsverket* or RFV) is the agency under the Ministry for Social Affairs that is responsible for central direction of activities of the national insurance schemes and for supervising the social insurance offices. There are 25 regional insurance offices, and a number of local offices in each region that provide services to the public. Each regional office is an independent constitutional

body, not a state or local authority. A board consisting of politically appointed members controls each regional office. RFV therefore has no formal jurisdiction over the organisation of disbursement of funds in each region. Nonetheless, it is instructed by the government to ensure uniformity and quality in the processing of the regions' insurance and benefit cases.

In 1998 RFV employed 750 people and 13 236 officials were working at the regional offices. The agency's organisational structure, outlined in Table 4.6, provides some indications of the nature of its duties. The administrative department deals with planning, finance, staffing, internal service and certain IT matters. It is also responsible for management objectives of the board and the regional offices. The evaluation department is responsible for data collection, statistical analyses, evaluation and supervision of voluntary pension insurance. The analysis unit is responsible for forecasting and prepares material for supply estimates. Two insurance departments handle issues that are directly related to the different insurance schemes, for instance the interpretation of legal documents and the implementation of general principles at the regional level. RFV Data provides the infrastructure for data support and common programmes for the whole organisation. From this description the agency seems to be organised with its eyes directed towards the bulk task of the organisation, i.e. the disbursement of money, and towards coordinating and monitoring the regional offices in doing this.

RFV classifies and reports the results of activities within the social insurance administration into three groups: (1) Processing and payment of benefits, (2) action against ill health and (3) analysis and quality assurance. Table 4.7 provides information about spending on the first two of these.

Unit	Staffing
GD staff and secretariat	12
Administrative Department	95
Information Department	28

Insurance Department I, including international contacts	38
Insurance Department II	67
Pension Department	46
Evaluation Department	64
Legal Department	26
RFV Data	342
Total	731

Table 4.6: Employees at RFV's main office in May 1999. Source: RFV.

Activity	Insurance cost	Administration cost
Payment of compensations	288,7	5,2
* thereof to families with children	(44,0)	(1,9)
* thereof for sickness and handicap	(70,6)	(2,3)
* thereof for old age	(164,9)	(0,8)
* other purposes	(9,2)	(0,2)
Measures against ill health	0,9	0,8
Total	289,5	6,0

Table 4.7: 1998 costs of social insurance, billion SEK. Numbers in brackets is part of the overall figure. Source: RFV (1999a), p 11.

Central government management of roads

The Ministry for Industry, Employment and Communications (*Näringsdepartementet*; subsequently referred to as the Ministry of Industry) was created on January 1, 1999, by merging four previously independent ministries: Labour, Transport and Communications, Industry and Civil Affairs. Its overriding objective is to provide prerequisites for improved welfare and to combat unemployment. The ministry is the principal of 39 agencies. Table 4.8 provides a list of the largest of these, their respective appropriations for 1998 or 1999 as well as their total number of employees. In view of the dispersed duties of the ministry, the agencies have responsibility for tasks within very different fields, requiring a wide range of expert knowledge in order to steer each and every activity according to its special requirements. In the same way as we saw for the previous ministries, there is a hodgepodge of big and small in the lot.

Name in Swedish	Name in English	Appropriation, mill. SEK	No. of employees
Arbetskyddsstyrelsen	National Board of Occupational Safety and Health	370	300
Arbetslivsinstitutet	National Institute for Working Life	146	400
Arbetsmarknadsstyrelsen och länsarbetsnämnderna	The Swedish Labour Market Board and county labour boards	68 485	9 133
Banverket	The Swedish National Rail Administration	7 477	6 700
Glesbygdsverket	National Rural Development Agency	24	32
Institutet för arbetsmarknadspolitisk utvärdering (IFAU)	Office of Labour Market Policy Evaluation	14	28
Jämställdhetsombudsmannen	The Equal Opportunities Ombudsman	14	22
Kommunikationsforskningsberedningen	The Swedish Transport and Communications Research Board	169	30
Konkurrensverket	Swedish Competition Authority	70	114
Patent- och registreringsverket	Swedish Patent and Registration Office	*	1100
Post- och telestyrelsen	National Post & Telecom Agency	550	165
Rymdstyrelsen	Swedish National Space Board	79	14
Rådet för arbetslivsforskning	The Swedish Council for Working Life Research	33	30
Skogsstyrelsen	National Board of Forestry	338	945
Statens Energimyndighet	Swedish National Energy Administration	199	170
Statens haverikommission	Board of Accident Investigation	1	13
Statens institut för regionalforskning	Swedish Institute for Regional Research	7	9
Statens institut för kommunikationsanalys	Swedish Institute for Transport and Communications Analysis	39	25
Statens väg- och transportforskningsinstitut	Swedish National Road and Transport Research Institute	33	240
Sveriges geologiska undersökning	Geological Survey of Sweden	210	300
Turistdelegationen	Swedish Tourist Authority	11	5

Table 4.8: Agencies with the Industry Ministry as principal. 1998 figures. *Fully funded by fees.

The nationalised corporate sector comprises 59 companies with in total 180 000 employees. Except for the ownership dimension, state-owned corporations operate on a commercial basis, much in the same way as any private enterprise. Dividends are channelled directly to the national budget. Each year the government delivers a report summarising the outcome of activities of state-owned corporations to *Riksdagen*. Ownership changes cannot be made without consent from *Riksdagen*.

Table 4.9 presents some enterprises under the control of the Industry Ministry, the main activity of each, number of employees and turnover in 1998. The table reaffirms the picture of a ministry in charge of a very wide range of agencies and corporations. Duties range from social concerns (cf. National Board of Occupational Safety and Health or the Equal Opportunities Ombudsman), over control and monitoring functions (The Competition Authority or the Institute for Transport and Communication Analysis) and research units (National Space Board or Institute for Regional Research) to large, commercial organisations (mining company LKAB or telecommunications company Telia, the latter now partly privatised).

In 1999 the ministry employed about 300 officials, excluding committee staff (cf. Table 4.2 above). Two ministers, one of them head of the ministry and the other his/her deputy, and five state secretaries comprise the upper political level. Another 12 persons are employed as political advisors or at other positions that would force them to leave after a change of government; in total 6 per cent of the Industry Ministry's staff are politically assigned.

Company (ownership share, %)	Type of business	No. of employees	Turnover 1998, mill. SEK
Affärsverket svenska kraftnät (100)	Ownership of electricity grid	240	2.300
ALMI Företagspartner AB (100)	Regional development companies	500	4.000*
AmuGruppen/Lernia (100)	Education, previously of unemployed	2.459	1.888
Assi Domän AB (50.26)	Forrest management, paper production, lumber	17.000**	24.000
Celsius AB (25)	Defence industry	11.000	14.000
AB Göta Kanal (100)	Management of canal for tourism	22	43
LKAB (100)	Iron ore mining	3.800	5.000
Luftfartsverket (100)	Ownership of national airports	4.719	3.576
Posten AB (100)	Postal services	42.100	24.400
Samhall AB (100)	Creation of work opportunities for handicapped	29.000	9.500
SAS Sverige AB (50)	Airline operations	27.000	40.900
SAQ Kontroll AB (100)	Technical inspection	650	500
SJ (100)	Train operations	15.700	14.800
Sjöfartsverket (100)	Operation of naval activities	1 400	1 300
AB Svensk Bilprovning (52)	Car inspection	2.200	1.100
Svensk-danska broförbindelsen SVEDAB (100)	Bridge ownership (Swedish share)	100	13.680
Svenska rymdaktiebolaget (100)	Space-related work	370	332
Sveriges Rese- och Turistråd (100)	Marketing of Sweden for tourists	4	4
Sveriges Provnings- och forskningsinstitut AB (100)	Development of technology for improving competitiveness in industry	558	401
Telia (100)	Telecommunication operations	30.600	51.000
Vattenfall AB (100)	Production and sale of electric energy	8.000	28.000

*Table 4.9: Examples of enterprises controlled by the Industry Ministry. *Stock of funds available for lending. **50% in Sweden. ***Net endebtment.*

The Swedish National Road Administration (*Vägverket* or VV for short) is the government's agency for road sector activities. While national roads comprise less than a third of the network length, more than two thirds of total traffic makes use of the national roads. VV is also responsible for allocating state grants to private roads eligible for national support.

During the 1990's, VV introduced the purchaser/provider paradigm on a broad basis. In this, 2 400 employees at the head office and the seven regional offices are in charge of defining and procuring all work to be undertaken to keep the road network in shape and

to construct new roads. About 40 per cent out of the total workforce of 6 400 employees are therefore concerned with this overriding management task (cf. Table 4.10).

Unit	Staffing
Consultancy (projecting etc.)	386
Ferries	396
Training & Development Centre	11
Traffic Survey Centre	62
Production	2 878
Main office and regions	2 360
Vehicle registry	306
Total	6 399

Table 4.10: Total number of VV employees working in different organisational units as of May 1999. Source: VV.

‘Production’ is a result unit within the organisation, not a corporatised enterprise. It places bids for construction projects and maintenance contracts in competition with private firms. In the same way, ‘Ferries’ produces river- and lake-crossing ferry services on behalf of the procuring part of the organisation; there is no competition for this task. ‘Traffic survey centre’ is a result unit responsible for maintaining a road database, selling services on a cost-recovery basis to users of this information, etc.

VV’s main office has about 900 employees. Its chief duty is to provide a common framework for regional activities and to allocate the road sector appropriations between regions. It has four means at its disposal to meet the given objectives:

1. To manage national roads in the capacity as purchaser of services. To this end, the national road management department, employing 24 officials, handles engineering aspects while the road transport system planning department (22 officials) co-ordinates the planning of these duties (cf. table 4.11). Some SEK 14 billion was spent during 1998 on road investment and maintenance, ultimately coordinated by this group of people.

2. To handle the sectoral task; this refers to the duty to co-operate and co-ordinate with all possible interests within as well as outside the road sector at large in order to develop the sector's activities.
3. To exercise public authority in the sector (*myndighetsutövning*). This includes the development and implementation of rules regarding vehicles, driving licenses, commercial transport and also administration of the system of grants given to private roads. The Sectoral and Official Services Directorate, comprising 76 officials is responsible for the management of tasks 2 and 3; Tables 4.12 and 4.13 summarises their respective spending.
4. To produce services, including projecting, construction and management of roads and other duties ordered by VV's procuring parts or by other purchasers (such as local communities) of services. Contracts for these jobs are won in competition with private enterprises.

Unit	Staffing
GD's staff, Secretariat and the International Secretariat	18
Internal Audit Office	8
Personnel and Human Resources Department	20
Information Department	35
Finance Department	39
Technological Development and Support Services Directorate	203
Information System Services Division	90
Internal Services Division	25
Traffic Safety Department	15
Environment Department	9
Road Transport System Planning Department	22
Sectorial and Official Services Directorate	76
Driving license administration, including regional offices	305
National Road Management Department	24
Total	889

Table 4.11: Employees at VV's main office in May 1999. Source: VV.

Taken together, this means that three fairly small divisions are provided with the operational responsibility for managing public funds allocated for use in the road sector

at large. Another two units – the Environment Department and the Traffic Safety Department – are given a complementary responsibility for environmental and traffic safety issues, respectively. These core duties are complemented by a number of traditional support functions, including personnel, economy, data etc., and a head-strong Technological Development and Support Services Directorate, providing all sorts of expertise on road and bridge design, traffic information as well as legal issues. If the administration of driving licences is excluded, close to 600 officials are concerned with implementation of road sector policies and less than 150 of these are in the ‘first line of duty’ with respect to management and policy formulation.

Sectoral activity	Appropriation, mill. SEK
Co-ordination of new settlements, road and transport planning	34
Public transport	5
Handicap issues	6
Commercial traffic	5
Environment	55
Traffic safety	308
Vehicles	7
Driving licences	2
Road informatics	88
Basic data collection	283
Research and development	226

Table 4.12: Vägverkets sector tasks and 1998 appropriations. Source: Vägverkets annual report for 1998.

Duty	Appropriation, Mill. SEK
Instructions (driving license regulations, traffic ordinance etc.)	24
Application of rules (vehicles, driving licences, administration of annual vehicle taxes)	471
Administration of state grants	1 361
- thereof to public-transport infrastructure (buss streets, construction of public-transport travel centres, information systems)	(722)
- thereof to private roads	(566)

Table 4.13: Vägverket's appropriations for duties relative to exercise of authority. Source: Vägverket's annual report for 1998.

Summary

Our simple description should suffice to illustrate the wide span of activities that the ministries are required to master. Whether they are equipped to do this or not is of course a question of resources. In the following section, we turn our attention to the most important of these resources – manpower.

4.3 Recruitment and appointment policies

Career paths, salaries, educational background

Civil servants in the cabinet offices are often recruited at a junior level. The main external source of recruitment is the agencies. In the foreign office administration, this often results in a life-long engagement, whereas employment in other ministries normally has a more limited time-span. The median time of employment in the ministries excluding the foreign office administration was 4 years in 1997; in the foreign office administration it was 14 years (Government Office memo, 1998-09-30).

For those who remain in the central government sector, long-term career paths sometimes go back and forth between ministries and agencies. A not uncommon pattern is that junior civil servants are recruited from agencies to their counterpart ministry and then return to senior level posts at the agencies. The fact that the staff's long-term career concerns are related to the agency rather than the Government Office level may affect strategic behaviour and loyalties among civil servants.

A 1995 investigation of relative salaries was based on the TNS system, widely used in the central government sector since 1992. The classification is based on the degree of complexity of the tasks involved, staff responsibility, knowledge required, versatility, and autonomy. The comparison indicated that salaries in the Government Office are between 6 and 19 per cent higher than in agencies for assignments that are comparable according to this classification. A somewhat more recent estimate limited to the

Ministry of Finance in 1997 indicated an average gap of just 1 per cent to the advantage of the ministry (Arbetsgivarverket, memo 1997-04-07).

Whatever the exact figures, results must be interpreted with some care. There are aspects not captured by the classification system that affect working conditions, such as unpaid overtime workload and the general stress level. Another important factor is that a number of Swedish agencies, as a result of conscious policy, are located outside the Stockholm area, where prices in general and housing prices in particular are considerably lower. Compensating for purchasing power would thus affect the comparison significantly for some ministries. Travelling times between the workplace and the residence areas are also lower outside the capital region. The latter, on the other hand, offers a rich supply of cultural activities that may be attractive to potential employees. On the whole, it seems difficult to give a distinct answer to the question whether relative salaries in the Government Office are competitive in comparison to the agency sphere or not. What is clear is that salaries are not used as a means to attract employees to the GO.

Government/agency relationships

Both interviews and published sources such as ESO (1998) provide additional information about the way in which the relationship between the Government Office and the agencies evolves. One important aspect is that the GO staff that are directly responsible for agency contacts have a junior position. Each agency is 'run' by a desk officer (*departementssekreterare*), normally with limited experience; in fact, this is often the first post that a person is given at the ministry. Large agencies may have one specific desk officer assigned to it, but in many cases one officer is in charge of the contacts with several agencies. It is considered to be an unimportant position for the future career, irrespectively if the person stays at the GO or moves on in the private or public sectors.

Moreover, there is a deliberate rotation policy, implying that desk officers are not allowed to stay for more than a few years. The purpose seems to be to avoid that the desk officer is captured by 'their' agency. A side effect is that few get the time necessary to develop a deeper understanding of the specific policy field of the agency in question.

Real-life exercise of power is much more than the formalised schemes of decision-making offered in textbook descriptions, whether one is dealing with law making or the

budget process. As will be further detailed in chapter 5, a budget is for instance settled after a lengthy process of communication between ministry and agency staff. It is in the end not obvious who really wrote the text of the budget bill and indeed of the issue letter. The process may also have included other affected parties such as the Parliament or the agencies.

This 'dialogue' between ministries and agencies in those processes is often highlighted as one of the strong components of the current system of administration, indeed an important component of the Swedish consensus tradition. Its main complication from an accountability point of view is that the dialogue is a closed instrument of communication. The public will not know what pressure a minister exerts during a meeting; indeed, ministerial rule – the only type of meddling into the affairs of agencies that the constitution explicitly rules out – may go totally unnoticed. There is some uncertainty also in the other direction; agencies may have a much larger *de facto* influence on policy making than justified by their *de jure* position.

A study by Ehn & Sundström (1997) reports about the generally poor contacts between GD and ministry. One alleged reason is the lack of time of ministers or GO staff, another that the political interest in the agency's activities is limited. An additional opinion stated in their interviews is that politicians don't want to provide the administrative head of an agency with 'too clear' instructions. It seems to be that an unclear relationship is 'a means to get away' in so far as politicians, if they avoid a more informed discussion, may claim ignorance; this is sometimes referred to as the 'deniability' dimension of governance.

Appointment policies

The Agency Ordinance establishes the GO's prerogative to select director generals to lead central government agencies and to assign the members of the agency boards (cf. further chapter 5.1 on this). As shown by Wallin et al. (1999), senior level posts both in the ministries and agencies have increasingly been populated by persons with a political

background. The fraction of persons appointed to senior levels that are members of a political party increased for all categories but one between 1971 and 1990, as illustrated by table 4.14.

	Party membership (%)	
	1971	1990
State secretaries	46	100
Directors-general	30	49
Under-secretaries of state	22	36
Senior officials (agencies)	21	18

Table 4.14: Party membership for certain categories of public-sector administrators. Mellbourn (1979); Wallin et al. (1999).

A study by Statskontoret (1999) focuses the heads of agencies and confirms this tendency. It uses a somewhat different definition, counting the fraction of directors-general that have had some previous political assignment during their career. In 1982, 20 per cent had such a background; in 1998, this figure had risen to 37 per cent. Of the directors-general that were assigned or re-assigned during 1998, 50 per cent had a political background. Among the 20 plus most important agencies, the ratio of directors-general with this background was 64 per cent.

There is consequently no doubt about the tendency that persons appointed to higher offices increasingly have a political background. This development is in stark contrast to the general development in Swedish society. The number of political party members in Sweden in general is steadily decreasing, across the board. It is currently at about 6 per cent of the population and would reach zero in 2013, if linearly extrapolated.

There may be several reasons for this development. Wallin et al. (op.cit.) note that more frequent cabinet changes, implying higher turnover rate also among state secretaries, has increased the demand for retreat appointments once the GO career is over. In the debate concerning these appointments, one argument has been that political experience is an asset to be acknowledged when candidates are selected. The two contrasting tendencies of a rising number of political assignments and a steadily decreasing number of political engagements in the population at large still need to be reconciled. It is difficult to see why the relative value of political experience should be steadily increasing. Moreover, the Parliamentary Auditors have criticised government

appointment policies (Riksdagens Revisorer 1994/95:12), requiring greater transparency in appointment procedures, pre-specified job requirements, a broad search, and a competent selection procedure.

4.4 Taking stock: Is there a serious imbalance?

The first and foremost requirement for proper government is that the government office has adequate manpower resources to provide support to the cabinet in its exercise of political power. The GO must also qualify for the role of competent partner in the exchange with the agencies. Necessary tasks of such a function include the following:

- ? continuous analysis of the relationship between politically formulated, abstract goals and the activities in the field in order to establish whether the activities are appropriate for the provision of services, of transfers, of investments, etc.;
- ? continuous defining and re-defining of the role of the state in the sector in focus;
- ? development of indicators of success and performance evaluation;
- ? analyses of the sector's external environment, i.e. of factors that may affect the preconditions of the activities, making contingency analyses and writing scenarios;
- ? separation of results generated by political decisions from exogenous change;
- ? analysis of the link between domestic policy and international commitments, notably within the European Union; productivity and efficiency analyses.

How many persons does it take to perform these tasks? It goes without saying that it is difficult to translate this succinct list of tasks into a specific number of man-years, or educational requirements. Not all the tasks enumerated have to be performed *in toto* in the government office. Minor or technical analyses can readily be delegated either to the agency in question or to some other external competent service producer. But the dominant part of the above tasks have to be carried out in the principal's own house;

they cannot be delegated without sacrificing control authority, in the absence of which they are pointless anyway.

Further, several of the tasks presuppose capacity for intellectually very demanding work. Translating political goals formulated in everyday language into operative targets, or separating the policy effects from exogenous change, are difficult tasks that require familiarity with mathematical modelling, statistical testing, etc. Research training beyond the basic academic level would be a prerequisite at least for some of the more advanced tasks.

Bearing these observations in mind, the previous sections can be summarised in the following way. There is no obvious imbalance with respect to salaries or educational background. There is, on the other hand, a severe shortage of capacity at the ministries to be responsible for analysis and communication with the agencies. The 100 plus man-years devoted to this exchange simply does not appear adequate, in particular given the tradition of assigning junior civil servants to these tasks. There is also a shortage of competence at the right level, which is not necessarily an imbalance between the GO and the agencies; basically, it is a question of having enough advanced analytical capacity in the GO prepared to address the complex issues involved in the performance management procedure.

The agencies are large, but an impression is that much of this staffing is used for running the own organisation. There are examples of policy units at agencies that in essence work with issues that primarily should be of concern for policy making, and thus logically belong in the GO. In the wake of policy tradeoffs that are not taken by policy makers, agency staff may moreover be forced to take a stand based on their own judgement. Still, the basic impression is that the agencies have their eyes turned towards their own organisation. If this is correct, policy analysis at large risks being neglected.

4.5 Organisation

One way to affect the management of public resources is via the organisational form chosen for an activity – agency, corporation, et cetera. A number of important public services have been corporatised, some of them also partly or wholly privatised. The previous semi-commercial agency for telecommunications, *Televerket*, was separated into a commercial part and an agency part, the former corporatised and then partly privatised. Also postal services have been corporatised and the new leadership has directives essentially to follow market principles.

A common experience has been that this separation has been difficult to carry out in practice, possibly because of a poor planning by the GO. In more than one case, some consequences of the changes were not fully expected, and political decision-makers have come back with new restrictions in order to maintain or reintroduce politically formulated targets, for instance concerning geographical coverage. In the case of railway services, the geographical-coverage problem was foreseen, and services along commercially unviable sections of the net were assured on the basis of public purchase.

Except for converting previous *affärsverk* to state-owned commercial enterprises and full privatisation, there is also a tendency to outsource parts of the 'old' agencies. The recent organisational change at *Vägverket* can be used as an illustration. As we have seen, the regional offices of the agency are responsible for allocating government appropriations between different activities such as winter maintenance, resurfacing, renewal of road markings, minor improvements, etc. What previously was production capacity is now placed in a separate organisational unit, the production division. It is still part of *Vägverket* but must now compete with private entrepreneurs for a range of assignments.

Under the previous integrated organisation, region officers designed a maintenance strategy and - in close communication with the people in charge of ploughs and trucks

and workers - were at least indirectly involved in the implementation of the activities. Different individuals may have performed the respective tasks but they did so in close communication with each other. A programme for pavement rehabilitation within a region was not established without knowing what resources were available during the year, which other - possibly complementary - activities that were to be undertaken, etc.

The regional office staff is not any more concerned with *how* things are done, but are much more precise on defining *what* to do. Elaborate targets for winter standard, surface quality etc are formulated well before bids for a contract are submitted. Once a contract is awarded, *Vägverket's* officials can no longer affect how the targets are met. This is a task for the entrepreneur that won the contest. The remaining duty for the procurer is to ascertain that the objectives that were set also have been accomplished. The targets must therefore be formulated in a way that makes it possible to measure *ex post* whether or not they have been met. One implication of the new organisation is that specialisation is taken one step further. Both the chain of information and the line of command of the previous organisation have been broken in order to enhance the cost efficiency of the activities.

From the procurer's point of view the position to act in situations where the delivery of services are of substandard quality has changed. A choice can today be made between different service providers, and failure by one can be remedied by using another. The possibility to choose was not available in the previous in-house organisation, and the competitive pressure is one important benefit with using a separated rather than a unified organisation. Another benefit is that the parties' respective roles are clarified, in particular that the producing unit can concentrate its attention to its specific area of competence. The new situation is often described to constitute an arms-length relationship.

It is important to emphasise that an arms-length distance between previously integrated units may be a necessary while not sufficient condition for improving productive

performance. Think of a regional officer at *Vägverket* that is instructed that the Production Division must be allocated a certain percentage of the total production volume. The officer may have grave concerns as to the quality or cost of the maintenance service undertaken by the Division. But as long as he is not entitled to contract with outside parties there is no credible threat to be made towards the in-house staff. Organisational separation without subjecting the producing unit to full competition is therefore not obviously beneficial.

For formal contracts to be reasonably effective in the public sector, a number of conditions have to be satisfied. Shirley & Xu (1997) review the experience from using performance contracts signed by developing country governments and the managers of their state-owned enterprises. In this, the government must explicitly state its objectives and translate them into measurable targets. In cases of multiple objectives precise priorities or weights must be assigned. Incentives can then be crafted for meeting the targets. Contracting governments will therefore need to consider the following dimensions:

- ? Reduce information asymmetries by improving accounting practices and the skills of negotiators and evaluators.
- ? Give the (principal's) bureaucrats and other actors involved in the contract discussion independence, adequate pay, stability and the power to punish any intentional misinformation or the withholding of information.
- ? Clearly specify and enforce high-powered rewards and penalties when the government has adequate information.
- ? Take politically costly actions at the outset and throughout the process to signal to managers that they have enough freedom to achieve their targets. This may include allowing layoffs of redundant workers or to regulate prices to permit an efficient firm to earn a reasonable return.
- ? Set up and abide by a neutral, third party enforcement arrangement.

- ? Design a contract with few (two or three) comprehensive, weighted targets that are stable over a period of time.
- ? Design self-enforcing contracts by, for example, making managers post a bond that they will forfeit if they fail to meet the agreed targets.

While these recommendations were formulated for developing countries, they provide relevant substance to the idea of using contracts in general.

Summary

The transition from traditional management regimes to more modern ones is difficult and requires detailed administrative and political crafting. Political decision-makers often want to maintain targets that go against the logic of the management principle they are about to establish, and must - if so - be clear on this in the design of the basic contract.

It is also worthwhile to think about these types of transitions on a more systematic scale than merely being a random change that takes place at different isolated spots. Consider the internal principal-agent relationships of our three example agencies. *Domstolsverket* is set to control a number of completely independent courts; *Riksförsäkringsverket* supervises twenty-plus independent regional organisations; and *Vägverket* has a regionalised organisation that today procures services competitively from both its own Production Division and from its commercial competitors. The obvious question is whether or not it would be feasible to introduce explicit contracting also into other agencies than *Vägverket*. Could the nature of the principal-agent relationship between ministry and agency change by restructuring the implementation of the activities that the agency is set to undertake?

We believe that there is reason to consider this possibility further. It is, however, related to the possibility of designing clear targets for the different parties, and this in turn is

related to the political targets that are given to agencies. We will therefore return to this possibility after having further studied the relations between GO and the agencies in chapter 5.

Chapter 5 Norms, budget and control

The present chapter is devoted to norms (5.1), budget (5.2) and control and audit (5.3). Section 5.4 illustrates the discussion with evidence from the three ministry-agency case studies. We also discuss in section 5.5 whether there is a change in the climate of trust between ministries and agencies.

5.1 Norms

Norms represent the traditional way of exercising public power. The parliament has the exclusive right to issue laws, but can delegate its power to the government in specific areas. Two general tendencies are of particular importance in this context. First, over the decades, there has been an increasing tendency for parliament to rely on general frame laws, and to leave the details to government via ordinances, i.e. laws decided by the government, not the parliament. This trend was noticeable already in the 1970's (Esping 1977). By consequence, the freedom of action of the government has increased. Agencies in turn have benefited from this development because the government office does not have the resources to develop the necessary legal instruments without aid from the agencies.

Second, there is in some fields an increasing, albeit uneven, interest in discussing economic instruments for the implementation of rules. This development, still in its infancy, is perhaps most noticeable in the area of environmental policy, but seems to be gaining acceptance in new areas (Ellerman 1999). This definitely represents a transition to a more modern format for the exercise of power.

The Agency Ordinance

The agency instruction is the basic formal instrument that the government makes use of in order to steer its agencies. It regulates the overriding objectives of an agency and provides the formal setting of agency activities. The instruction for each specific agency

fall back on a framework given by the Agency Ordinance (*Verksförrordningen*, SFS 1995:1322).

The Agency Ordinance establishes that the Director General (*Generaldirektör* or GD) is responsible for the agency's activities and shall make sure that activities are conducted according to law and in an efficient way. The GD is employed by government decision and the government also assigns the members of the Board, each member appointed for a limited period of time.

The Ordinance assigns sweeping duties to the GD. He or she is ultimately responsible for that employees are well acquainted with the agency's objectives, that the Board is informed about the activities and that the government is provided with appropriate information in order to consider the scope and direction of the agency's activities.

Responsibilities also include the following items:

- ? to manage government funds efficiently;
- ? to guarantee that the agency co-ordinates its activities with other agencies to the benefit of the government as a whole;
- ? to constantly review and re-consider the agency's own activities, and – if required – take necessary measures;
- ? to take into consideration requirements on the agency's activities implied by defence concerns, regional policy, an ecologically sustainable development and equality between the sexes;
- ? to ascertain that the general public's and outside parties' contacts with the agency are characterised by good service and accessibility;
- ? to ascertain that the agency is organised so that accounts, the administration of public funds as well as the agency's activities at large, are appropriately held and monitored.

An agency can organise its activities in the way it finds appropriate, subject to general laws and regulations. Agencies are obliged to support the government in activities related to the European Union. This includes a responsibility to keep the government informed about the involvement in such work of the agency's personnel.

Each formal decision of an agency shall be documented, registering date and the content of the decision, who is responsible for it, who presented the case and who participated in the final handling of the case without being formally responsible for the decision. All decision documents are subsequently kept in a registry and are available to the general public; this is one formal component of the openness of the Swedish public sector.³

Agency instructions point out the broad direction of agency activities, and they provide a large set of boundary restrictions but it is obvious that they do not provide a basis for accountability enforcement. The sweeping formulations make it difficult for any GD to claim ignorance with respect to objectives. The formulations are, on the other hand, not drafted with the view to take a malfunctioning GD to court.

It is also worth to refer back to what was said about the position of the chief executive officer of agencies in chapter 3. The point was that the position of this person, in principle, is very strong, irrespective of if this is formally corroborated or not; authority rests at the top. The agency instruction provides prima facie evidence of that this is so also pro forma. Any decision that is not formally delegated is taken by the GD.

5.2 The budget process

The budget process and the documents that are produced for this purpose form the core of the government-to-agency relationship. The process is initiated in November a year

³ The public may, in addition, request access also to documents that have not been registered delivered for reading. This must be granted, except for when the agency is able to claim that such a document is still being processed.

plus before the budget year starts. In the financial spring bill in April, the government sets out the overall financial restrictions for the coming three years, including next year's budget, i.e. its total size and the respective allocations to different expenditure areas. The Parliament's vote on this proposal lays down the financial restrictions for the subsequent process.

The government sends its budget proposal to the Parliament in mid-September. Here, the Parliament is informed about the precise allocations for different fields. The budget's 27 policy areas (*politikområden*) are ordered so as to comprise homogenous types of activities. The budget proposal provides information about the precise allocation to each of the expenditure areas and their subtitles and it outlines the government's political ambitions at large. In particular, it provides the platform for agency steering.

During the autumn months after the delivery of the budget proposal, the Parliament takes a separate decision about the detailed appropriations for each of the expenditure areas. On the basis of this vote the government drafts the issue letters (*regleringsbrev*), one for each agency. While the budget proposal outlines the government's general policy ambitions and is directed to the Parliament, the Issue Letter transforms overriding policies into precise agency instructions. Since the inception of MBO reforms, the Issue Letter is therefore the formal instrument for policy implementation and governance of the agencies.

Formally, the Issue Letter is sent to an agency just before Christmas. The process during the fall season however works to make the agencies aware of the content of the forthcoming instructions for the coming year. Each agency is, for instance, provided with a draft of those parts of the budget proposal that are relevant to the agency already before the text is submitted to *Riksdagen*. In the same way, the content of the forthcoming Issue Letters is gradually becoming more and more clear during the fall season's different deliberations. Informal contacts between the government office and the respective agencies are intense with almost daily contacts during the period when

the issue letter is formulated, typically November and December (ESV 1999). This notwithstanding, the political process may well result in non-trivial changes of instructions and appropriations shortly before the new budget year starts. The agencies' need to plan their activities may therefore be jeopardised by the short time-span between the formal decision in parliament and the start of the budget year.

The government has recently confirmed its commitment to performance budgeting. In a report delivered by an interdepartmental working group an assesment is made of the steering process. The point of departure is a perceived need to further strengthen the content and quality of the decision material made available to politicians, in particular to clarify the link between results and financial steering. Also *Riksdagen* has confirmed its wish to maintain and further develop the steering filosophy. Moreover, work by the VESTA group has presented an ambitious attempt to establish a complete set of performance indicators for the central government sector (Ds 2000:63).

To conclude, it is obvious that the changes in the budget process from 1992 and onwards have been successful in establishing control over the spending of public funds. As we will elaborate on further in the next sections, it is less clear whether these resources are used efficiently.

5.3 Control and audit

Control activities have two purposes; first, to make the controlled party accountable for its accomplishments and failures and secondly to learn from previous successes and failures. The public franchise is the basic accountability enforcement mechanism by which a government at large is held responsible for what it has achieved in office. Within central government different auditing mechanisms are used to ascertain that administrators do what they are supposed to. A management process based on performance measurement has monitoring and ex post assessment as one of its

cornerstones; this is the practical tool for ascertaining that the government gets value-for-money. The power of control is executed by way of review, monitoring and by legal means.

The first line of review of performance and results comes from within each agency. As indicated by the agency ordinance, the GD is required to make sure that its activities and accounts are "appropriately monitored". Most agencies therefore have an internal group of auditors monitoring what goes on within the walls of the organisation.

Agencies are also required to submit an annual report to the government. The ordinance regulating this obligation (SFS 1996:882) specifies a large number of items that are to be commented on, including data on achievements relative to objectives. The ordinance is formulated in very broad and imprecise terms.

The Swedish National Audit Office (*Riksrevisionsverket*, RRV) is the organisational centrepiece of the government's monitoring. Based on the Annual Reports submitted by the agencies, RRV examines the accounts and performance of all agencies and public enterprises and also certain state-owned companies and foundations. RRV's mandate and independence are based on statements made over the years by consecutive governments as well as by the Parliament. The agency carries out some 20 self-initiated performance audits each year. A parliamentary statement also indicates that if the government commissions RRV to undertake a certain task, this work shall be separately financed. In this way, resources cannot be diverted from RRV's self-initiated audits.

The instrumental purpose of having RRV review the agencies' annual reports is to establish – on behalf of the government – how the agencies have implemented the Government's decisions, how they follow rules and regulations and whether the accounting of the agencies are kept in accordance with generally accepted principles. The most important observations and conclusions on the year's activities are summarised in RRV's own annual report. In this, RRV's opinion about the general state

of affairs in the central government administration is expressed. Negative remarks made relative to the performance of an agency is commented on in the government's spring bill.

In the Annual Report of 1999 (RRV 1999) the agency points out that the border between what is the responsibility of ministries and agencies, respectively, is increasingly blurred (Ibid. p. 6). Performance budgeting requires clear instructions about how goal satisfaction and results are to be reported. According to RRV, agencies become gradually more dependent on informal contacts with (political) representatives of the government and the Government Office's officials. Moreover, several agencies today use substantial resources for what could be referred to as staff activities for the ministries, i.e. to undertake work commissioned by the ministry. The end result is that the agencies' role gets increasingly more opaque. The ministerial steering of agencies is therefore referred to as "informal hands on". This has important repercussions for the subsequent enforcement of accountability; who has, in reality, taken a decision?

RRV suggests that measures should be taken to improve monitoring and *ex post* assessment and to increase the weight of this at the agencies' senior management level. The auditors are also concerned over the inappropriate attention given to these issues by the agency boards.

The 1999 report also comments on the general content of the agencies' Annual Reports (ibid. p 20 ff.). Rather than providing the government and ultimately the Parliament with the most significant information about results and achievements, the tendency is to turn the reports into lengthy presentations of most aspects of what the organisation has been concerned with during the year that has passed. It is noted, however, that a primary reason for this is the vagueness of much of the text in the Issue Letter. The following specific features are also noted:

- ? An Annual Report is typically not a comprehensive product with a clear structure but a sequence of chapters reporting different activities in different ways.
- ? There is an insufficient ambition to ascertain that the information provided in the Annual Reports is of acceptable quality. In particular, references to material that could corroborate the statements that are made are not given.
- ? The efforts to compile an Annual Report start late, and more often than not an explicit analysis of achievements relative to targets is missing. The board of the organisation has little time to discuss the report before it is submitted to the government.

Ekonomistyrningsverket, the Swedish National Financial Management Authority (ESV), previously a part of RRV's organisation, was established in 1998. Its objective is to ascertain high quality financial management in the public sector. ESV (1999a) provides a comprehensive assessment of the economic management in central government. Based on a review of the economic management of the agencies, a summary quality assessment is reproduced in Table 5.1. The main importance of this type of assessment is said to be that it identifies negligent agencies, not as a basis for any formal accountability enforcement.

The Parliamentary auditors (*Riksdagens revisorer*, RR) monitor central government activities at large, including the performance of the Government Office, which is not to be controlled by RRV or ESV. Based on suggestions from the Parliament's different Standing Committees and from individual MP's, the organisation is free to choose its focus of study. The ensuing reports are sent out to parties affected by the conclusions in order to invite comments on the draft. A case is concluded by submitting a document to parliament and in some cases to the government. Parliament then handles a proposal from RR in the same way that it deals with governmental proposals, i.e. the suggestions are prepared in the relevant Standing Committee and finally voted on in the chamber.

	1994/95		1995/96		1997		1998	
	No. of agencies	%	No. of agencies	%	No. of agencies	%	No. of agencies	%
Fully satisfactory	111	44	162	67	186	81	166	72
Satisfactory	120	47	60	25	28	12	45	19
Not satisfactory	22	9	19	8	17	7	21	9
Sum	253		241		231		232	

Table 5.1: ESV:s assessment of the agencies' performance with respect to economic administration. Source: *Ekonomistyrningsverket* (1999a), p. 37.

According to a review of the organisation's activities during the 1991-94 period, there is a notable long time lag from that the auditors submit a report to the competent standing committee until the committee handles the report. Furthermore, in 54% of all cases where RR criticised some aspect of activities that were reviewed, this did not result in any response by the relevant standing committee. Out of 59 motions (*yrkanden*) put forward during the 1993-94 parliamentary year, 54% were bluntly rejected. In only 9% of the cases, the proposals were accepted (Rothstein et al 1995, p 120; cf. also Ahlbäck 1999).

A report from *Riksdagens revisorer* may provide significant informal signals about problems in the way in which the government is being run. The authority of the audit reports relative to actual decisions taken in the chamber however seems to be low. A further concern is that the auditors may be biased both in their choice of issues to review and with respect to their propensity to submit critical reports. This is natural in that the majority of the auditors is the same as the majority in the chamber and consequently the party(-ies) constituting the government.

A recent decision in parliament will substantially change the landscape of auditing in Sweden's Central Government. Starting in 2003, a new auditing institution under the parliament will be Sweden's main national auditing resource.

Monitoring in central government also includes the parliaments standing committee on constitutional matters (*Konstitutionsutskottet*). The committee's prime objective is to control the way that ministers perform their duties and handle separate cases relative to what is said in the constitution. *Riksdagens ombudsman* reviews the way that public-sector authorities implement laws, acting on behalf of the general public. The Chancellor of Justice (*Justitiekanslern*) is the Government's tool for judicial review of public sector performance.

There is reason in this context also to mention two recently established agencies with evaluation and monitoring tasks. The Office of Labour Market Policy Evaluation (IFAU) is an authority under the Ministry of Industry, Employment and Communications. Its objective is to promote, support and carry out research on the effects of labour market policies, study the functioning of the labour market and evaluate labour market effects of measures within the educational system. It therefore undertakes independent evaluations of activities undertaken by other agencies based on state-of-the-art methodology.

The Swedish Institute for Transport and Communications Analysis, SIKa, is an agency under the same ministry, established in 1995. SIKa has three main areas of responsibility; to carry out studies for the Government, to develop forecast and planning methods and to be responsible for official statistics within this sector.

Although SIKa's monitoring duties are less clear than those of IFAU, the two institutes illustrate an alternative – or rather supplementary – method of keeping an eye on agency performance. IFAU has a solid institutional knowledge about its sector and can use this not only to analyse queries from others but also to formulate and answer relevant questions themselves. The potential shortcoming of a sector-specific auditing unit is that it may become a nuisance to the agencies that they are set to control and that they abstain from raising the touchiest questions. IFAU has at least partially mitigated this risk by their physical co-localisation with a university department with strong

credentials in the field. Agency staff often has an academic career in parallel with their tasks as auditors. This makes IFAU more independent of the agencies or of the ministry that it is set to review.

Conclusions

In countries with bicameral or presidential rule, politicians have obvious incentives to monitor the performance of the government's executive branch. Sweden's one-chamber parliamentary system lacks similar incentives for autonomous and "automatic" control of policy implementation. In order to hold the government accountable, it is therefore all the more important that the formal structure for monitoring and review is strong.

Like in most countries, the Swedish programme for reviewing and monitoring of activities in its central government is ambitious on paper at least. It is probably true to say that action is taken as soon as formal rules are broken. A different question is whether public resources are efficiently used. This is important, since the Government Office's instructions to its agencies are imprecise; it is obviously more difficult to hold someone accountable for a particular decision the more inexact the assignment is.

The strong position of agencies with respect to control over information is a further complication. An agency has no reason to make information that would criticise its performance available, or indeed to ascertain that it is produced in the first place. Government officials must be trained to commission such information from the agencies. Standard tools for productivity analyses or performance comparisons are currently not used, although there is a longstanding experience from application in the most diverse areas (ESO 1994 for general productivity; Johansson & Nilsson 2001 on unit cost comparison in the railroad sector; Ylvinger (2000) on DEA analysis of *Bilprovningen*). In some areas, the basic information necessary to perform the analysis is not even collected (Forslund et al. 2000 on labour market programmes).

We believe that the new auditing institution holds promise for creating a good platform for autonomous analyses of public sector performance. The creation of several IFAU-type agencies could be a supplementary institution, primarily for ascertaining that auditor has a similar knowledge about the business he or she is set to control as the agency officials. In addition, Government Office officials must be skilled enough to formulate issues to be analysed and to digest the results of the ensuing reports. In the absence of high-level analysis capacity, there is otherwise a risk that neither parliament nor the public will receive the kind of material that they need to assess properly the performance of the sector. We think that it is strong reason to be critical on this point, and intend to return to it in chapter 8.

5.4 Governance in practice

Domstolsverket

In the 1999 Budget Proposal (Prop 1998/99:1, expenditure area 4) the judicial system is told to settle cases in a way that (i) ascertains the rule of law and (ii) is efficient. Both objectives are said to be difficult to measure, and both may be influenced by a large number of external aspects that also are difficult to measure. There are, however, some indicators that are believed to provide an image of how the rule of law and the efficiency in the judicial system is developing. These are, first, the number of incoming, settled and balanced – i.e. non-settled – cases during a year, and, secondly, the accessibility to, and composition of personnel at courts.

Some five pages of summaries of achievements in these dimensions are reported for the different categories of courts (Ibid. p 68 ff). The concluding assessment is that the situation is "acceptable" in district courts and the Supreme Court while it is "difficult" in the courts of appeal and the common administrative courts. The turnover rate is said to be "too long" in the county administrative courts and the administrative courts of

appeal. Moreover, both of these courts have an "unsatisfactory" large balance of taxation and social insurance cases. The common courts are said to decide cases "within reasonable time" while the opposite conclusion is drawn about taxation and social insurance cases in administrative courts. The government therefore asks for measures to be taken in order to reduce the time for handling separate cases and to create a more efficient organisation of courts.

The issue letter is more precise with respect to DV's objectives. It also presents complementary information with relevance for the allocation of funds between different parts of the judiciary system. A separate section settles activity objectives and the results that the ministry wants to be informed about, both for courts and for DV.

The government's wish to reduce the time for processing cases, and the intention to improve the age-structure of cases is for instance given better precision. Courts of appeal, district courts and county administrative courts are instructed to ascertain that the median age for cases settled during the year should be two months for criminal, and eight months for taxation cases. A target is also given for the share of balanced cases that at the end of the year are older than six and 12 months, respectively. To be able to suggest similar targets for future budgets, the Supreme Court is asked to suggest explicit activity targets for a couple of other areas.

In general, DV is asked to report back results both for each class of courts (Supreme Court, etc.) and for each category of cases. It is said to be essential that the records provide a comprehensive picture of the activities. The agency shall therefore not only report about the objectives explicitly fingered in the courts' activity objectives, but also about possible other matters of relevance for the government's steering of the sector. Comparisons with a national average shall be conducted.

Processing time is indeed one important aspect of what goes on at a court of justice: For those involved on either side of the bar, it would be unacceptable if it took too long time

before verdicts are passed. Improved performance in this respect could signal higher productivity, but there is always a risk for that this is accomplished at the expense of the quality of the verdicts; the less time allocated to a case, the larger is the risk that the wrong decisions are taken. This conflict between objectives is not put in print in the documents that have been reviewed.

Riksförsäkringsverket

RFV's prime responsibility according to its instruction (SFS 1998:739) is to make certain that the social insurance system works smoothly. A large number of laws regulate the rights of the citizens in periods of illness, disability etc. and the agency shall ascertain that all get their entitlements according to these laws. The disbursement of money gives rise to a number of problems that goes back to interpreting what, more precisely, is meant by the laws, but it is up to the agency to handle these tradeoffs in a clever way. All this work shall be undertaken with the lowest possible administrative costs. We can therefore think of RFV as being in the first place a money disbursement agency that is to handle its task with acceptable accuracy at the lowest possible (administrative) cost.

RFV's ordinance provides it with in total 20 tasks except for the above. We can note the following here:

1. RFV shall ascertain that measures are taken to prevent illness and reduce ill health in order to reduce long periods of sickness;
2. it shall supervise the regional insurance offices;
7. it shall be in charge of a common data system for RFV and the regional offices;
8. it shall have a supportive and consultative function for internal auditing at the regional offices and in that line of duty consult with the National Audit Agency in matters of major concern;

16. it shall follow the development of both the insurance system and other subsidies and assess the consequences of these systems for individuals and the society;
17. it shall develop forecasting models and be responsible for the forecasting and analyses of how expenditures from the social insurance and subsidy systems administered by RFV and the regional offices.

The assignment in item 2 differs from the other duties. Here, the agency is told to ascertain that measures are taken to prevent illness and reduce ill health, i.e. to coordinate and implement activities that reduce the risk for that people fall ill. This includes rehabilitation and preventive activities in order to encourage people with long sickness periods to train for new jobs and to provide appropriate information about these possibilities. Instead of just implementing a given set of rules at lowest possible costs, RFV is here given a rather vague instruction to deal with far more elusive parameters. One reason for that RFV is given this 'third branch of activity' is the dire consequences that long periods of illness have for the insurance bill.

This task is different from other assignments since it is complicated for the government to ascertain whether the assignment has been appropriately dealt with. Another difference is that long sickness periods have a large number of reasons, most of them outside the control of RFV. This is another illustration both of that an agency is given multiple objectives and that the possibility to hold the agency to account for its performance in some of these is much more difficult than for others.

In the introduction to the 1999 Budget Proposal the government reiterates its ambitions that the social insurance shall be safe, fair and efficient. The insurance system shall moreover be continuously adapted to changes in the preconditions for everyday life. In section 3.3.4 the government gives its overall view with respect to expenditure area 10 (economic safety at sickness and for the handicapped). It is said "to be serious" what RFV has reported with respect to the handling of certain insurance policies (prop 1998/99, expenditure area 10, p 27). This comes as a direct reply to a report that the

agency has submitted to the ministry. That report established that the way in which single sickness, rehabilitation and early retirement cases had been handled was not satisfactory; many instances with incomplete acts and where matters regulated by law are missing in the acts were observed. While this not necessarily means that incorrect decisions have been taken, it does indicate that sufficient quality cannot be guaranteed. The government therefore thinks that there is a need for further action and also that RFV should put more effort into the development of quality control instruments.

This is an example of a formalised part of the dialogue between the two parties. It also illustrates the diligence in pinpointing formal wrongdoings, a hallmark of Swedish accountability enforcement. This does not necessarily mean that the identified problems are important for the actual assessment of agency performance.

The regional insurance offices have reported increasing unit costs for administering several insurance schemes. To make it feasible for the government to follow and assess the possible reasons for such trends properly, reliable measurement and analysis instruments are required. The government notes that there are major variations between different regional offices with respect to costs, quality and handling times. In order to draw conclusions about which measures that are necessary to improve performance, clear causal relations are required. RFV is therefore encouraged to improve the quality of information about results, costs etc. for the coming year. It would be natural to go one step further and establish a system of recurrent productivity comparisons. As pointed out in section 5.3 above, the appropriate analytical instruments are available.

As for sickness benefits and support to the handicapped it is said that four different activity objectives had been established and that neither of these has been met. RFV suggested that the reason for under-performance could be that priorities have been adjusted during the budget period in question and that the time to undertake consequent adjustments of the activities had been insufficient. Additional reasons for the failure are discussed and the government does not propose further action.

Section 5 of the chapter is devoted to the administration of social insurance. It is noted that RFV and the regional offices have analysed results and that they seek to meet quality targets by way of "increased priorities and improvements". The government concludes that "(t)he work can therefore be considered to have been undertaken according to given goals." (ibid. p 46.) This part of the text signals that the ability to assess performance and suggest measures is weak.

RFVs Issue Letter starts by repeating the overriding objectives for each of the expenditure areas from which RFV is allocated resources. Let us take but one illustration of the nature of the "activity objectives" given to the agency. For "The handling and disbursement of compensations" objective 1 is that the activities shall be undertaken with high quality and at lowest possible cost. Cheating and abuse shall be minimised. The degree of goal satisfaction shall be reported and commented on for the major benefit systems with respect to throughput time of single cases, their average cost, insurance cost and administration cost. The following dimensions shall also be accounted for and commented on; the opinion of the insured; problems and deficiencies in the formal basis for decisions; possible critiques from *Justitieombudsmannen* and *Justitiekanslern*; observed cheating and abuse; efforts to counterbalance cheating and abuse as well as the costs for doing so and an assessment of its' effects. While representing relevant pieces of information it is difficult to realise in which way the consequent huge mass of information will be used by the Government Office.

Vägverket

We have just established that the social insurance system is based on laws that lay down (more or less precise) rules for eligibility to receive child allowances, principles for sickness remuneration, etc. It is then RFV's task to implement these rules at the lowest possible cost. It is less straightforward to spell out by law under which preconditions a new road is to be built, how that road should be designed or when snow-clearance patrols should leave their garages in order to ascertain agreeable winter driving

conditions. This is one reason why the interaction between political priorities and implementation is stronger in the road sector than in several other parts of the public sector. Another reason is that road sector activities have implications for several objectives, to be further established below.

Two policy decisions within the transport sector, the Transport Policy Statement of 1998 and the recent Investment and Maintenance Programme, are of particular importance in the context of governance.

At approximately 10-year intervals, subsequent governments have come to appoint a parliamentary committee to review transport policy issues of the day and to suggest new principles for future policy making in the sector. Based on committee proposals, the government presents a Bill to the parliament, which subsequently is debated and then accepted as the Transport Policy Statement. New statements were established by *Riksdagen* in 1963, 1979, 1988 and – most recently – in 1998. While policies are adjusted also in-between omnibus policy decisions, it is probably fair to say that basic principles are not changed by ‘ad hoc’ decisions.

The overriding principle of the subsequent Transport Policy statement of 1998 (prop. 1997/98:56) is that transport policy shall contribute to a socially, culturally, economically and ecologically sustainable development. The primary objective is to ‘...ascertain citizens and business of an economically efficient and sustainable supply of transport services’ (Ibid. p 1). This is further substantiated by way of five complementary objectives related to accessibility and quality of transport, transport safety as well as environmental and regional development concerns.

A recent academic dissertation reviews the work of this committee. One conclusion is that pressure from special interests, the road lobby, strongly affected the final recommendations of the report. In particular, the government's initial intent to increase

taxation of road traffic in order to curb environmental harm was curtailed (cf. Melin 2000).

An adjacent document is *Nationell plan för vägtransportsystemet 1998-2007*, a 10-year plan specifying priorities for investments into new roads and for maintenance activities. In order to provide the Parliament with the opportunity to take a stand on sector priorities after each general election, the programme is revised every fourth year. The first comprehensive plan proposal was ready in October 1997 (cf. *Vägverket* 1997). The core of the National Road Programme is a priority list for investment projects. If future appropriations would come to deviate from the estimate, it is still the priorities given by the programme that are to be followed. The document also comprised a Programme for Measures within the Environmental and Safety Areas and a Programme for Other Sectoral Areas and Exercise of Authority.

Vägverket's draft programme was sent out on an extensive hearing round. Most public sector bodies with some interest relative to these issues and commercial interests outside the public sector were invited to comment. It is also possible for anyone interested to submit comments to the proposal. Based on these comments, a new version was produced by VV and sent to the Ministry in March 1998. In June 1998, the government took a decision based on this proposal (cf. Skr. 1998/99:8).

In the government's decision it is noted that measures that previously have been taken by VV to improve traffic safety have so far not had the expected consequences. For this reason, VV is instructed to reconsider its priorities; the agency must submit a revised program that gives safety-enhancing activities a higher priority. The government's decision also implies that the *Vägverket* proposal is overruled with respect to some specific investment projects. The agency is told to delete some of these altogether, whereas it should get back to the ministry with proposals for a new design etc. of others. Since the agency submitted a list of investments that would exceed the given planning frame, it is also told to reduce the overall size of the program so that it fits into the

budget assessment given in the March 1997 decision. This represents a non-typical interference in the priorities set by the agency that by assumption is best informed to tell how objectives can be met.

VV's ordinance (SFS 1997:652) gives the organisation a position as the government's central administrative agency with a comprehensive responsibility - a sectoral responsibility - for the road transport system as a whole. In this, it shall work for that the transport policy objectives are met, and it shall be "unifying, supporting and pushing" relative to other affected parties (Ibid.1§). In particular, *Vägverket* shall ascertain

1. that the accessibility and efficiency of the road transport system is ascertained and to support a regionally balanced development in the country,
2. that the road transport system is adapted and designed to meet high environmental and safety standards,
3. that vehicle safety and environmental performance standards are developed,
4. that road informatics systems are developed and put to efficient use,
5. that the competitive strength of public transport is enhanced,
6. that appropriate concern is given to the demand of the functionally defunct in the road transport system as a whole and that the handicap adaptation of public transport is co-ordinated over modes of transport,
7. that commercial traffic is made safe, adapted to environmental demands and efficient and that it is pursued under equal conditions for the firms,
8. that socially motivated research, development and demonstration activities within the framework of the road transport system is planned, initiated, implemented, documented and monitored and that results are publicised,
9. that necessary knowledge and information within the agency's field of responsibility is disseminated, and
10. to safeguard Sweden's interests in the international work concerning roads, vehicles and traffic.

Except for activities relative to road transport at large, *Vägverket* is also in charge of planning, construction and operation of state roads (the traditional concrete-and-bitumen duties of a road agency). This includes

1. issues concerning traffic, both on roads and in the terrain,
2. the design and maintenance of records for car, driving and commercial traffic licenses,
3. matters concerning driving licences, driver education and driver tests,
4. matters concerning commercial traffic,
5. matters concerning vehicle quality and equipment,
6. matters concerning handicap adaptation of public transport on roads,
7. matters concerning the technical design of road installations,
8. matters concerning the delimitation of road corridors,
9. to assess work plans for road construction projects,
10. to allocate, and to monitor the use of, state grants to private roads, to regional public transport authorities and to municipalities, and
11. to co-ordinate the submission of applications of financial support from the European union to Swedish road construction projects.

The only reason to reproduce this long list of responsibilities is to emphasise the range of the agency's "sector responsibility". One consequence of these formulations is that the borderline between the responsibility of the political level and that of the administration is blurred. Moreover, with so many objectives and instructions, making priorities becomes more difficult, the nature of the assignment is further obscured, and it will at the end of the day be the agency that makes the tradeoffs.

Expenditure area 22, item 4 of the *budget proposal* specifies allocations for roads and railways. The text for the 1999 budget year (prop 1998/99:1) refers to the established National Plan for the Road Transport System, and notes that changes were made of

VV's proposal with respect to safety measures. This illustrates how the long-term programme is put to use for the annual decision-making.

Based on VV's Annual Report of the previous year the budget proposal then comments on the development in the sector. A summary is given of traffic growth statistics, and significant governmental activities in the sector are presented. The effects of these measures and activities are presented under the headlines of efficiency, accessibility, safety, environment and regional balance. The material is primarily of a descriptive nature with no normative comments. Repeated notes are however made of that information to measure whether objectives are met or not is not available.

In a separate section some complementary comments are passed. A key sentence is the following: "It is the government's assessment that activities in the road and railway sectors during the year have contributed to meet the transport policy objectives by improving accessibility, regional balance and environmental adaptation in the transport system." (Ibid. p 26) The ministry's affirmative but vague judgment is hardly surprising against the background of a huge and imprecise sector responsibility.

A more specific comment is made with respect to an observed increase of the number of fatal and severe road accidents. VV has reported that if the current trend is not broken, the target for fatal accidents during 2000 will not be met; the government has stated that no more than 400 fatalities should occur during this year. After some comments, the following statement is given: "The government has confidence in the new direction of *Vägverket's* activities (to break this negative trend; our comment), but believes that it is important to strengthen traffic safety activities in the short run and to speed up the work towards the zero vision." (Ibid p 27.) The latter refers to the government's long-term ambition to reduce and ultimately eliminate all fatal road accidents.

In the Issue Letter, VV is told to account for its activities according to the four categories of resources at its disposal; the exercise of sector tasks, the exercise of

authority, the management of national roads and finally production activities. A large number of explicit targets are set, including the following:

- ? By the year 2000 the number of people killed in traffic accidents shall be below 400, and the number of severe injuries reported to the police shall be below 3 700 per year. The following statistics shall be reported to the government: the number of killed and severely injured, separately accounted for by category of road principal and category of drivers; the number of reported drunken drivers; the percentage of both drivers and passengers using safety belt; the percentage of cyclists using helmet; speed limit violations; the average speed on different categories of roads; the public's knowledge about, and attitude towards traffic safety.
- ? Total emissions of carbon monoxide from the road transport system shall be reduced, and emissions in dense, built-up areas of NO_x, hydrocarbons and particles shall be reduced. Noise disturbances from road traffic shall also be reduced. Estimated emissions in tons separately accounted for more and less densely populated areas and for different classes of vehicles shall be reported. The number of apartments and houses exposed to road traffic noise exceeding 65 dB (A) equivalent level shall be reduced.
- ? The share of functionally disabled, of elderly and children who can make use of public transport on roads shall increase. The share of functionally disabled, elderly and children who can make use of public transport on roads shall be reported.
- ? The operation of national roads (winter clearance, painting, cleaning of signs, bush clearing etc.) shall be implemented in an efficient manner at the same time as specified requirements for accessibility, traffic safety and a good environment are met.
- ? The agency's Production Division is to operate in a way so that its engagement in maintenance activities can be based on a profitability target corresponding to that of the industry at large.

The government's attempts to control VV generates several problems. First, the agency is not only given several partly conflicting objectives. Both accidents and environmental damages can, for instance, be reduced by lowering the speed limit; this would increase the time for drivers to get from origin to destination substantially. There is virtually no discussion of these conflicts in the texts.

A second problem is that the agency's ability to meet the targets is severely restricted. As for accidents, means include speed limits and road designs that reduce the risk for accidents and the probability to be injured or killed if and when an accident occurs. But the agency can not affect the design of vehicles. It can inform about the dangers of drunk driving but it does not have access to any policing resources, which would otherwise affect the number of controls of violations in this respect, or for that sake speeding controls. And it can certainly not influence the business cycle which is important since a prime explanation for increases in traffic volumes, and concomitant increases in the number of accidents, goes back to swings in the country's economic activity. It is of course difficult to hold anyone accountable for the possibility to meet a target that obviously is so far away from the control of that agency.

Third, the last of the above targets also points to the agency's involvement in business-like activities. In order to level the playing-field, the Production Division must be required to pay dividends in the same way as its competitors. This and the previous objective illustrate the extremely diverse obligations of the agency.

5.5 Is there less trust than before?

Organisational separation is motivated by the need for specialisation. The agency is better informed than the ministry about matters of significance for implementation. The agency typically has information that is highly relevant also when objectives for the sector's activities are established and when the agency's instructions are to be drafted,

but this is primarily a task of the political level. One implication of the separation of tasks is therefore that many agencies are asked to dole out appropriations on behalf of the principal.

Our review has presented indications of that this separation of duties is increasingly blurred. It was for instance noted that the ministry overruled *Vägverket's* priorities in order to upgrade safety-enhancing measures. We have also established that the basic way to prioritise is for the responsible agencies to create a programme and to implement according to this list as and when appropriations are reserved for this purpose.

Riksdagens Revisorer (2000) however reviews four very large investment projects that were planned and settled outside the ordinary process, allegedly since they might at least partially be funded in "alternative" ways. The competent ministry had a much more direct saying on these projects than on others.

The report from *Riksdagens Revisorer* notes that the information available about the four projects is poor and their potential for enhancing social welfare unclear. In particular, the social value of these investments is inferior to that of other spending activities undertaken by the agencies. In these cases it seems to have been easier to get approval for large-scale projects by circumventing the ordinary planning procedure and appeal to political aspects of the decisions.

During the autumn of 2001, county governors were asked to submit their own priority lists for future road and railway investments. The alleged purpose was to acquire a solid basis for a forthcoming bill on infrastructure spending over the next 10 years. But, as we have seen above, *Vägverket* has spent much effort and a long planning process in order to derive an investment programme that takes all different types of aspects into account and that has been available at the ministry for quite some time. This programme of course (implicitly) makes the tradeoffs between the wishes of different regions. We have also seen that regions have been consulted during the planning process. The

Government Office obviously considers itself better positioned than its agency to merge regional requests into a comprehensive national programme.

An investment programme for environmental purposes provides another example of the tension between the parties. During the spring of 1998, a few months before the election that year, the incumbent government doled out some 2.3 billion SKr to 42 out of 115 local communities that had applied for subsidies for local investments towards environmental sustainability. Dahlberg & Johansson (2000) identify two distinct problems with the design of this particular system. The first is that the authors have, ex post, had difficulties to establish on which grounds that the funds were allocated. Any type of state support to local government has traditionally been allocated on the basis of strict rules, established well before the decision was taken, and typically endorsed by a decision by *Riksdagen*. Such norms were missing in this particular case.

Second, much of the allocation decisions were handled directly by the Government Office, rather than by the Government Office after a proposal by the competent sector agency. The authors empirically test a model that tries to explain the allocation of grants in order to win votes. They find strong support for a model design in which parties distribute transfers to regions where there are many swing votes.

Taken together, this has led to concerns that the constitutional rule on equal treatment of individuals and municipalities may not be respected (*Riksdagens Revisorer* 2001). It also obscures the separation of duties between politicians and administrators. One possible reason for this is that the Government Office no longer trusts their agencies, the material that they deliver or the priorities they make. Except for mistrust, the Government Office may also have more dim objectives with interfering, as exemplified by the study of allocation of environmental funds above.

5.6 Conclusions

The above, relatively detailed account of the communications between the government office and three agencies leads us to a few general observations:

- ? The principal and the agent are in principle set to handle different tasks. One feature of Sweden's system of governance is that it is often difficult to realise both who has the formal authority to take a decision and who has the real authority. This seriously affects the transparency of the system.
- ? Transparency is further jeopardised by the lengthy consultation processes and the urge to bring "all interested parties" into the decision process. At the end of the day, nobody stands completely free from the final decision that is taken.
- ? The problem in any system with poor transparency is related to accountability enforcement; who is to be held *ex post* responsible for problems and failures?
- ? Goals are multidimensional and partly conflicting. No guidelines are issued for trade-offs between conflicting goals. New goals are added without a deeper analysis of the relationship between these and previously established goals.
- ? In important respects, the outcome of agency activities depends both on the efforts of the agency in question and on exogenous forces of change. In the (few) auditing reports that are presented, few attempts are made to separate one from the other.
- ? The systems for reward or punishment are poorly developed. Career possibilities in bureaucracies are an important tool, but generally too blunt. We have pointed to the possibility of using information, for instance relying on productivity analysis and unit cost comparisons.

The rationale for targets is straightforward. What matters at the end of the day is what public services deliver - their outputs - not what resources they absorb. Since the public sector is not subject to the same competitive pressures as the private, it requires external pressure to improve its performance. That is what targets are supposed to provide. The presentation has demonstrated that no simple answer can be given as to the success of

the agencies ability to meet established targets; the systems are simply not designed and fit for that purpose.

In several ways, targets can be said to be a harmless way to govern agencies. And any system for governance in a hierarchical system is fraught with paperwork and costs generated by the system itself. A more serious concern is that an excessive use of specific targets may reduce the freedom of local managers to respond to local needs; it restricts the ability of those closest to implementation to take relevant information into account. We have also established the obvious risk of inefficient allocation of effort if some objectives can be given explicit targets while others can not. Successes in one area may then come about at the cost of substandard performance in other fields.

The closed nature of the interaction between principal and agent(s) is also a serious threat to system performance. As long as the government chooses to write and mark its own school reports, its use of targets will suffer from low credibility. The creation of a separate agency such as IFAU provides a hint how this problem may be dealt with.

Chapter 6 Recent reform in the UK and New Zealand

Every national government has some independent agencies that do not fit into its ministerial or departmental structure. But with the exception of Sweden and Finland, systematic reliance on free-standing agencies to deliver public services is a recent development that has been spurred by the innovative concepts and practices of new public management (NPM). Stripped to its essentials NPM asserts that the efficiency and quality of public services improves when managers are given operating discretion and are held accountable for results. Entrusting operational independence to agencies is notable because the agency structure runs counter to the century-long practice of placing public services in functionally integrated departments.

NPM has two core objectives. One is to "let managers manage" by deregulating the use of financial, human, and physical resources by service providers; the other is to "make managers manage" by specifying what is expected of them and how their performance will be judged. This *quid pro quo* — more discretion in exchange for more accountability — is promoted by carving out specific areas of responsibility for each agency and empowering its managers to operate as they deem appropriate. But having exercised discretion, managers must also account for what they have done and accomplished. The two sides of the bargain are interdependent: managers cannot be accountable for performance if they lack freedom; and it is imprudent to give them freedom if they are not accountable for what they do.

As independent entities, agencies contribute both to operational flexibility and to managerial responsibility. Enforcing accountability requires that, although agencies are operationally independent, each is responsible to its minister or department. Having been separated from departments, they remain tethered to them by means of performance indicators, reports and targets, evaluations and reviews, and other instruments of accountability. Performance is the shared concern of departments and

agencies: It links policy and operations, politicians and managers, money and programs, plans and results. Properly implemented, accountability is an amalgam of information and power. It requires both a stream of data on what was expected and what has been done, and persons in high position who maintain watchful vigilance over actions and results. If those in authority don't pay attention, information on performance will make little difference.

This chapter focuses on experience with agencies as facilitators of performance and accountability in Britain and New Zealand, two of the boldest and most innovative NPM governments. Both countries have creatively deployed agency independence to reorient public management from compliance and control to performance and results. As will become obvious, the countries have gone about their reforms in different ways, but both are instructive case studies on contemporary management innovation.

6.1 The UK: Government by agencies

"Next Steps" is the popular term applied to the initiative to entrust service responsibility to autonomous agencies. During the dozen years since Next Steps was launched in 1988, more than 150 agencies employing approximately three-fourths of the civil servants working in central government have been established. Pursuant to periodic reviews, some agencies have been privatized or reorganized so that the number currently in operation is lower than the total created.

As its label indicates, Next Steps was not the first attempt to improve public management. The Thatcher Government elected in 1979 tried a number of reforms, none of which had much impact.⁴ Having failed, the Government commissioned an inquiry to decide what to try next. The remedy, according to the 1988 Next Steps report, was that agencies "should be established to carry out the executive functions of

government within a policy and resource framework set by a department."⁵ Although the first part of this recommendation has received more attention, the second part, which speaks of the departmental role, is of equal weight. Agencies were to be set free, but only under the tutelage of their departments. In fact, when operational work was transferred to the new agencies, departments retained large headquarter staffs to handle policy and oversight responsibilities. These staffs number in the many thousands, and it was only in the late 1990s that the Government undertook a fundamental review of departments to examine whether they were overstaffed.

The logic of Next Steps is spelled out in the following way in a revealing account of work in an agency, as seen from the vantage point of the head of the Prison Service. The theory behind the "Next Steps" initiative for the creation of executive agencies had been relatively simple. It was a myth that ministers ran major government services such as the Benefits Agency or the Passport Office; they had neither the knowledge nor the skills to do so. But as long as the myth persisted, the civil servants, who were really in charge of the day-to-day operations, were not being given the authority to get on with the job, nor were they being held responsible for the performance of the agencies. The intention was to describe more precisely the respective jobs of ministers and civil servants, and to get away from the confusion that had existed hitherto. Ministers would be responsible for setting policy, approving the agencies' plans, setting targets and monitoring performance; the civil servants in charge would be given the autonomy to get on and make it all happen. The performance of the agency and its chief executive would be closely monitored by key performance indicators. Chief executives would generally be appointed on fixed-term contracts so that if they did not achieve the targets set for them by ministers they could be removed more easily. Agency status also brought with it many tools that were commonplace in the private sector. The essentials were: clarity of roles, operational autonomy, the delegation of decision-making and

⁴ The main pre-Next Steps innovation was the financial management initiative, launched in 1982. See OECD (1997), pp. 115-6.

⁵ HMSO (1988), paragraph 19, p. 9.

holding agencies and their chief executives responsible for results. (Lewis (1997), pp. 64-65.)

This description refers as much to the role of ministers as to that of chief executives. The two are twined together in ways that require each to perform for the relationship to prosper. Yet precisely because it requires an ongoing relationship, the Next Steps idea raises numerous questions. Where should the line be drawn between ministerial and managerial accountability for resources and results? What flexibility should be given the chief executive and what matters should continue to be dictated by departmental mandarins? What should be done when the two sides have different views on how performance should be defined? What about other parties to the relationship, such as the Treasury which controls the purse strings and the Cabinet Office which steers the overall reform effort? These and other important questions would have to be answered by experience, not by *ex ante* decisions on how Next Steps agencies should function.

Imposing accountability on the organizational structure

The life cycle of each organizational unit, from initial designation as a candidate agency through launch to annual and periodic review, provides some substance to the Next Steps relationship. The process includes 8 stages, each contributing to the seriousness with which accountability is taken.

1. Candidate status: The Next Steps process accepts that the manner in which an agency is established strongly influences its subsequent performance. It does not suffice merely to designate an agency, incorporate it under relevant law or regulation, and issue Cabinet or ministerial guidance. Instead, an agency designated as a candidate remains in this status for an extended period, typically 3-9 months, during which appropriate reviews are conducted and a framework for its operation is agreed. Only after these

steps have been completed is a determination made on whether the entity should be operated as an agency.

In almost every case, a Next Steps agency is a successor to a pre-existing entity. Newly-chartered, the agency inherits the old staff, along with its offices, operating rules, habits and organizational culture. Nothing automatically changes just because an entity has been re-created as an agency. The process of creating a Next Steps agency seeks to impress on managers the need and opportunity for change. The period prior to launch is the opportunity for taking a strategic look at the entity and spelling out what needs to be changed and how the desired changes may be achieved. Ideally, candidate status should energize the agency with a sense of purpose and direction.

2. Design options: During candidacy, an intensive review is undertaken of the prospective agency's mission and managerial capacity. During Conservative Governments, the review probed deeply into whether the government should continue to provide the particular service or contract out to the market sector. In the present Labour Government, less priority is given to privatization or contracting out. The review involves central departments (Treasury and Cabinet Office) as well as the affected ministry. Inasmuch as the review may raise fundamental questions, it typically takes several months, after which a decision is made on creating the agency and defining its mission.

3. Ministry-Agency relations: The responsible ministry is involved in all stages of agency creation. But the launch of an agency does not settle all issues concerning its operations. Each agency must work out its relationship with the parent department, not only in the framework document (discussed in the next subsection) but also in ongoing operations. Although each agency is supposedly autonomous, it is legally dependent on the department that "owns" it and also may be the customer for its services and the supplier of all or most of its operating funds. When the department is the sole or dominant customer, it may exercise de facto control by writing detailed contracts

specifying the services to be provided. For example, the Ministry of Agriculture, Fisheries and Food has written 3-year contracts for the research to be conducted for it by the Central Veterinary Laboratory, one of the Next Steps agencies. In addition to this umbrella contract, more than 200 annual contracts are negotiated in some years between the department and the agency, specifying the amounts to be paid and the work to be done.

Even when departments give agencies room to maneuver, the relationship is inherently fuzzy. The chief executive serves as the agency's accounting officer, while the permanent secretary is the department's accounting officer. The latter's statutory responsibilities have not been formally altered by the arrival of the former on the scene, but only one of them can have final accountability. The chief executive answers to Parliament on agency matters, but the minister answers on all matters, including those nominally in the agency's purview. The government has repeatedly insisted that Next Steps does not diminish ministerial responsibility. It distinguishes between responsibility, which can be delegated, and accountability, which cannot. *De facto*, however, agencies have altered the responsibilities of ministers and senior departmental officials.

4. Framework Document: Next Steps intends that departments delegate but remain in charge. They must guide and oversee, but not dictate or intervene. They have to let go while still being engaged, especially when problems arise. Drawing the line between their proper scope of action and operational autonomy for agencies has not been easy. The issue is confronted at launch when each agency is given a framework document (FD) that spells out the policy and resource conditions under which it is to operate. The FD is negotiated by the agency and its parent department, with Treasury and Cabinet Office looking over their shoulders to uphold the government's interest in financial discipline and managerial competence. Although Treasury has insisted that there is no standard format for the FD's — each should be written to the circumstances of the

affected agency — most have common features, and as Next Steps has matured from novelty to business-as usual, these documents have come to resemble one another.

The typical FD concisely sets forth the agency's mission, its aims and objectives, the financial conditions under which it is to operate, responsibilities of the chief executive, relations with the parent department, accounting and audit arrangements, and various financial and personnel matters delegated to the chief executive. The FD is not quite a full-fledged contract, but it is much more than an informal understanding. It is a formal arrangement, hammered out in bilateral or multilateral negotiations, as to what the agency will do, how it will operate, and how the respective parties will relate to one another. It draws the line between departmental control and agency independence. It drives home the message that the agency has only delegated independence.

The FD's greatest value comes in negotiating it. Drafting the framework requires the candidate agency to consider how it is to be transformed from a dependent unit in a large department into a free-standing organization. This can be an empowering process that helps an agency develop the skills and self-image needed to operate with much greater autonomy than it previously had. The FD does not ensure a smooth relationship, but it does establish ground rules and expectations for how departments and agencies are to interact.

Although it sets forth various terms for the agency's operation, the FD has relatively little impact once the agency is underway. Departments and agencies do not refer to it when they have problems. When they disagree the two sides must work out a fresh understanding; it does not help much to claim that the FD dictates how the matter should be resolved.

5. *Chief executive*: A critical issue in department-agency relations is whether to continue the existing leadership or to recruit from outside. Dealing with this question involves not only an assessment of the qualifications of candidates for chief executive, but also

the extent to which the government wants to promote change. With delegated autonomy, the chief executive is supposed to lead the agency and not just serve in a caretaker capacity. In many cases, the success of start-up agencies depends on breaking with the past, and on infusing them with fresh ideas and methods. Judging from the number recruited from outside the public service, the government has tended to seek change rather than status quo. And judging from a number of cases in which the chief executive has been sacked, it appears that the government has not always gotten the leadership it hoped for.

6. *Performance targets.* Next Steps agencies and their chief executives are assessed in reference to performance targets set by ministers. Each year, the Government publishes a *Next Steps Review* that summarizes the performance of executive agencies, reports on each agency's progress in meeting the previous year's targets, and specifies targets for the year ahead. Additional targets are published in corporate or business plans and the agency's annual report. Service quality targets (timeliness, accuracy, citizen satisfaction, etc.) have been published pursuant to the Citizen's Charter, and measurable progress in meeting targets features prominently in periodic evaluations of agencies and in the award of bonuses for chief executive performance. This sustained focus has sharpened attention on how well each agency is doing in meeting its targets.

Several characteristics distinguish targets from other performance measures. Most of the targets relate to efficiency, outputs and service quality, matters within the direct control of the agency, and less on outcomes and impacts. The targets are specified in advance, giving agencies notice of what is expected and establishing a basis for comparing results against these expectations. A small number of key targets are selected, rather than a large number of measures that cover the various things it does. These features have been favored because the principal function of the targets is to hold managers to account, not to assess the effectiveness of government policies. For targets to serve as measures of managerial performance, they must pertain to matters within the competence of the agency. Further, they must be sufficiently few in number to permit a clear judgement on

whether the agency has performed as expected, and they must be measurable so that results can be precisely stated. They must also be in a form so that agency managers can take appropriate steps to meet them, and they should permit the measurement of trends over a number of years.

The targets do more than just inform the chief executive and other agency managers what is expected. Because they are precise, narrow and few, they influence managerial behavior. The targets pressure agencies to raise output, improve productivity, shorten response time, reduce customer complaints, recover a higher percentage of costs, and so on. Because the targets are so transparent, it is easy to determine whether an agency has fallen short of expectations. Occasionally, failure is so evident and public interest in the issue so high that the chief executive is replaced. This occurred in the Child Support Agency, which targeted that it would complete child support arrangements in 60 percent of the eligible cases. Performance data revealed, however, that it had completed arrangements in only about 30 percent.

The pinpoint focus on measurable targets has come at some cost. The measurements are not as challenging as the Government wants them, nor as broad as they might be. Giving testimony before Treasury and Civil Service Committee in 1993, Sir Robin Butler, head of the civil service argued: "Unless you set ambitious targets, you don't get people to achieve more than they think they can achieve ... All targets should be difficult to achieve." (House of Commons, 1993/94, p. 62.) Seven years later, Mo Mowlam, Minister for the Cabinet Office, complained "... too many targets are not stretching enough." (Executive Agencies 1999, p. 5.)

The problem with these demands is that if targets were truly difficult, many would not be achieved, despite the agency's best efforts. Rather than energizing agencies to improve performance, difficult targets might demoralize them. The perceived success of Next Steps has depended in substantial measure on achieving a high percentage of the prescribed targets.

In fact, meeting most of the targets has been the norm for Next Steps agencies. In 1992-93, the government reported that all agencies combined achieved 77 percent of the key performance measures; the next year they achieved 80 percent, and the year after that the success rate reached 83 percent.⁶ By the end of the 1990's, approximately three-quarters of the key targets were being met each year (The Stationery Office 2000, p 14). Evidently, most targets have been set so that they would be reached. Achieving them may still require managerial skill and effort but the task facing agencies has been to reach reachable targets.

Although reach has been more valued than stretch, the government has sought to induce steady improvement in performance by having each year's targets set higher than the previous year's. It has had only modest success, however, in raising the bar. In 1998-99, only 34 percent of comparable targets were higher than the previous year's, 50 percent were the same, and 16 percent were lower. For 1999-2000, only 29 percent were set at a higher rate. Even more disappointing to the government is the fact that in both 1998-99 and 1999-2000, half of the targets were below the previous year's outturn (Ibid. p 18).

The relevant minister, usually in consultation with the chief executive, sets the targets. They are not imposed unilaterally, nor in disregard of the agency's judgment as to what can be reasonably expected. When targets are raised, the projected increase usually is modest. An agency that targets a 4 percent efficiency gain one year but achieves much greater improvement might aim for 4 percent again the next year.

Output and efficiency targets inevitably narrow an agency's focus to operational issues and internal management and discourage it from addressing broad policy questions. At least two important factors have impeded a program orientation in Next Steps. First, the logic of Next Steps calls for policy matters to be in the competence of departments and

⁶ See HMSO 1993, HMSO 1994, HMSO 1996.

for agencies to run operations. This division of responsibility emphasizes specific output measures for agencies and policy or outcome measures for departments. But because departments were slow in taking a strategic role, progress in assessing effectiveness was limited in Next Steps' first decade. Second, the Thatcher-Major Governments were not interested in active policy planning; they had a more limited, service-providing view of government. It should tend to the programs entrusted to it, but not undertake big plans for the public sector. As discussed in the next section, the Blair Government has taken a broader perspective, not only as regards performance measures but also concerning the role of departments.

Government statements recognize the tradeoff between specified and broad measures of performance. A 1994 White Paper declared that "targets need to cover the breadth of an organization's activities to avoid resources being redirected toward areas where performance can be easily measured, and away from areas where measurement is more difficult." (HMSO 1994, p 21.) Despite this the government did not change its strategy until the Blair Government adopted a "whole of government" perspective and shifted its main reform focus from agencies to departments.

Consideration of performance measures would not be complete without noting the progress made under the Citizen's Charter in setting quality standards for services. The Charter required that standards be set in absolute terms; they should be published and made available to service users; users should have remedy when performance falls short of the mark; and superior service should be recognized. The development of service standards was promoted in the 1990s by media and public interest, the publication of their own charters by many departments and agencies, and the issuance of Charter Mark awards for exceptional performance. While some critics dislike the Charter's promotional style, its attention to services is thought to have brought visible improvement by sensitizing providers to customer needs and interests.

7. *Annual Reports*: Annual reports have become standard practice in countries that have set up autonomous agencies. Each agency publishes financial statements in conformance with accepted accounting principles, also provides descriptive and statistical information on activities and performance. All Next Steps agencies follow this practice, but they differ in the quality and coverage of their reports and in the extent to which they present and analyze variances between actual and targeted performance. In Britain, many agencies approach the annual report as an opportunity to present themselves in a favorable light. It is a rare agency that probes problems or disappointments.

8. *Periodic Evaluations*: As part of the Next Steps process, every agency must be evaluated periodically. The initial policy was for reviews to be conducted every three years; the current practice is for an evaluation at least once every 5 years. The evaluations, which are conducted and commissioned by the parent department, have generally been thorough and objective. They look both backwards to how the agency has been managed and forward to how it might be changed. The review considers the agency's status and inquires whether it should be continued; if it is, adjustments often are made in its framework document.

The reviews have not been mere formalities. A number of agencies have been terminated; others have been restructured or have had the mission redefined. The reviews have made extensive use of quantitative data on performance. For example, the assessment of the Employment Service relied on output and outcome measures, customer satisfaction surveys, and examination of agency operations. It concluded that the Employment Service is "a firmly performance-driven organization, clearly focused on achievement of its key objectives This has led to continuing improvements in the quality of its services and the efficiency of their delivery."⁷ Not all assessments have

⁷ Employment Department Group, *Employment Service: An Evaluation of the Effects of Agency Status 1990-1993: Summary Report*, paragraph 7.1. p. 34.

been favorable. An outside consultant for instance criticized the parent department for undue interference in the work of the Veterinary Laboratory.

A brief assessment of Next Steps

It is inherently difficult to assess an initiative that involves so many agencies and cuts such a broad swath across government. But a fair assessment is that Next Steps carved out robust managerial enclaves in the public sector. Many agencies reported dramatic, ongoing gains in efficiency and in service quality, often exceeding the targets set for them. Many targets may not have been as challenging as they could have been, but to those working inside agencies, they often required tough choices on deploying resources, organizing work, and changing staff attitudes.

Many agencies brought in new managers from outside, not only at the top but also in middle ranks where operations are carried out, and exuded a sense of freshness and excitement during their early years. Agency status has liberated them from encrusted controls, not to the extent they want, but to a far greater extent than before Next Steps. Many agencies still complain about meddling departments, but the gripes appear to be stimulated by the freedom they have gained. For a newly-empowered agency, any intervention by the department is apt to be seen as a trespass on its managerial autonomy.

On the basis of evidence given by numerous officials and observers, the Commons Treasury and Civil Service Committee expressed the view that "Next Steps represents a significant improvement in the organization of Government and that any future Government will want to maintain them in order to implement its objectives for the delivery of services to the public." House of Commons (1993-93, para. 168.) This assessment appeared to have been shared by the Blair Government when it took office in 1997 following 18 years of Conservative rule. It continued Next Steps, though some

features, such as market testing, were de-emphasized. But reform moves on, and by the end of the 1990s, Next Steps was no longer a new concept. Many agencies had been in operation for almost a decade, and what was once fresh and exciting was now standard procedure. Government improvement needed to be invigorated and, as things turned out, redirected as well. Without disowning Next Steps, the Blair Government has distanced itself from agency-centered reform. It has done so by shifting the focus to departments and the center of government.

Back to the departments

A clue to the new thinking is contained in the Table of Contents to the most recent Next Steps review, re-labeled Executive Agencies Review. Instead of listing agencies in alphabetical order, which was the previous practice, the Table of Contents only lists departments; it has no entries whatsoever for agencies. This may seem a small matter; it is not. The rationale for listing agencies is that improving public services requires easy, transparent access by citizens to the Government agencies directly serving them. Rearranging the report signals the sub-ordination of agencies to their departments. In fact, this is only one of the several signals that future effort to improve management is vested in departments rather than agencies.

The Thatcher-Major Governments of the 1980's and 1990's concentrated on agencies as service providers because their previous reforms directed at Whitehall, the cluster of departments headquartered in London where the senior civil service is congregated, had failed. Whitehall was run, and may still be, by an administrative elite, recruited from the right schools and valued more for discernment and discretion than for technical expertise or specialized knowledge. Whitehall was a closed world of shared values and outlooks, in which experienced careerists glided from one department to another as they moved up the administrative ranks. (Modernizing Government, Cm 4310, March 1999, p.6.)

Next Steps did not directly challenge this privileged world, for doing so might have yielded the same meager results as had ensued from previous initiatives. Instead, the government reformed by indirection, seeking to undermine the vast bureaucracies by stripping away major managerial responsibilities. Over time, the government hoped, departments would be shrunk into policy units, providing guidance and advice but not

services. Whitehall mandarins did not fight Next Steps because they had little interest in the messy, labor-intensive side of service delivery. Their political and policy networks remained intact, and they continued interacting with ministers and with one another as if nothing important had changed. In effect, departments kept what they cared about, and surrendered what they didn't.

Of course Next Steps and Thatcher's pressure to downsize government reduced departmental staffing, as Table 6.1 shows. But the more remarkable finding is the large staff that remains with departments. At about the time Blair became Prime Minister, the average-sized British department had more staff than the entire Swedish Government Office (excluding the foreign service). The two central departments – Treasury and Cabinet Office – have thousands of employees engaged in policy work and in monitoring line departments and agencies.

Before Blair, the Government promoted downsizing through fundamental expenditure reviews (FER's) conducted on a department-by-department basis. FER sought to get departments to face up to the reality that they were no longer involved in operations and therefore did not need to be as amply staffed as they once were. But the FER's were undertaken by the affected departments, which meant that some were less probing than if outsiders had conducted them. Each department drew its own conclusions; staff was trimmed but still remained quite large.

Table 6.1: Staff of British departments excluding agencies. Staff numbers are expressed in full time equivalents. Customs and Inland Revenue, departments organized along Next Steps lines, excluded. Source: Cabinet Office.

	1990	1995	1998	2000
Agriculture, Fisheries, and Food	9,291	6,403	5,812	6,630
Cabinet Office ¹	1,179	1,519	1,063	1,750
Defense	139,555	83,736	44,637	37,670
Education and Employment ²	16,983	6,521	4,504	4,970
Environment	5,983	4,518		
Environment, Transport, and Regions			4,758	4,830

Foreign and Commonwealth ³	9,168	7,041	5,412	5,420
Health	5,436	3,437	3,491	3,570
Home	42,868	9,566	8,073	9,270
International Development			1,055	1,210
Lord Chancellor	10,637	1,222	835	910
Scotland	10,251	4,268	3,436	3,810
Social Services	78,318	2,793	2,770	2,880
Trade and Industry	8,023	5,144	4,434	4,700
Transport	6,475	2,300		
Treasury	2,288	1,127	893	830
Wales	2,321	1,924	1,880	2,410
Other Civil Departments ⁴	9,650	11,082	4,178	650

Notes: 1. 1) Includes the Office of Public Service, which was incorporated fully into the Cabinet Office in 1998. 2) Combines the staff counts for the Departments of Education and Employment in 1990 and 1995. These two departments merged into a single Department of Education and Employment in 1996. 3) Includes the Overseas Development Administration in 1990 and 1995. The ODA was replaced by the Department for International Development in 1997. 4) Due to ambiguities in the status of some units, these departmental totals may include agency staff.

While the Blair Government did not repeal Next Steps, it did not view agency-centered management as critical to its modernization agenda. Public services were only one element of Blair's vision. Modernization meant that services would be responsive and of high quality, but in contrast to Next Steps, which pursued these aims through fragmentation, Blair did so through integration. Moreover, instead of separating policy from operation, modernization wanted them joined.

The Modernising Government White Paper published near the end of Blair's first year did not even mention Next Steps but turned it on its head. Rather than taking services out of departments, it made them central to departmental performance, and rather than relying on agencies for service performance, it placed accountability squarely on departments. Further, rather than assuming that Whitehall could not be reformed, the modernization program relied on departments to promote change. "Within Whitehall," the White Paper insisted there should be "a new focus on delivery — asking every Permanent Secretary to ensure that their department has the capacity to drive through achievement of the key government targets and to take a personal responsibility for ensuring that this happens." (Modernising Government, Cm 4310, March 1999, p.6.)

Where does this new orientation leave agencies? Only time can tell, for the Government is inching away from Next Steps in small moves, such as revising the table of contents one year and not publishing the Next Steps Review the next year. Agencies remain, but if departments rule, it is questionable whether agencies can hold on to the operational autonomy promised them.

Autonomy, the new reforms suggest, gets in the way of policy cohesion and service integration. This theme is strongly implied in *Wiring It Up*, a manifesto on integrated service delivery issued by Cabinet Office in 2000. Revealingly subtitled "Whitehall's Management of Cross-Cutting Policies and Services," the report recommends stronger leadership from Ministers and senior civil servants" and "using the centre (No. 10, the Cabinet Office and the Treasury) to lead the drive to more effective cross-cutting approaches wherever they are needed" (Cabinet Office 2000). The report extolled "the current Whitehall structure" for its vertical management, with Ministers at the top and service providers and their clients at the bottom. "Such vertical management structure is highly effective in delivering many of the Government's key policies." (Ibid. section 3.1). The model presented here is of hierarchy, with rules and guidance flowing down and compliance and information flowing up. How else, the Blair manifesto reasoned, can the government ensure that cross cutting policies made at the top are faithfully implemented below?

The *Modernising Government* model has a much different view than had been conceived by Next Steps and related initiatives. While the agency model promoted the breakup of the civil service into distinct enclaves, *Wiring Up Government* argues that civil servants need to get better at working across organizational boundaries. This report also envisions central government partnering with local authorities to coordinate and improve the delivery of services across government boundaries. The critical negotiations would be between departments and localities, with agencies participating as departmental subdivisions rather than as autonomous entities.

The third managerial leg of the Modernizing Government agenda has been to make departmental public service agreements (PSA's) the centerpiece of performance targeting. The annual expenditure review process has been expanded into means by which departments negotiate formal, published agreements on what they will accomplish in the next three years. The PSAs, which are agreed by Treasury, link resources and results by specifying the targets each agency commits itself to achieve. The most recent PSAs, for 2001 to 2004, set out approximately 160 targets as "transparent commitments which the Government can be held accountable for, and which departments will report on every year in departmental reports."⁸

As in other recent initiatives, the role of agencies has been defined in terms of contributing to their department's performance. Pursuant to the PSAs, departments publish service delivery agreements (SDAs) detailing the concrete steps they will take to improve services. These deal specifically with the things that agencies do. The job of agencies in this top-down process is not to define targets but to take actions needed to implement them.

To promote its integrated strategy, the Government has issued new instructions for conducting the 5-year reviews "to ensure that the right structures for these bodies are put in place, so that they deliver the Government's agenda effectively, and work in an efficient and integrated way." Moreover, the reviews should take account that "Agencies do not exist in isolation from the rest of Government, and so greater emphasis will be placed on considering the performance of Agencies in the context of their contribution to wider departmental and governmental objectives."⁹

Although the recent reforms deal with departments, much of the impact will be felt by agencies. From a strictly legal point of view, little has been changed. However, the fact

⁸ See 2000 Spending Review: Public Service Agreements, Cm 4808, "Introduction."

⁹ Ibid., p. 24.

that departmental performance on services is now emphasized inevitably eats into agency autonomy. Agencies are to do their department's bidding, even if it means doing things the department's way rather than their own.

In view of the fact that the new arrangements have been in effect for 2-3 years, it would be premature to assess their impact or durability. But it appears that Tony Blair has taken charge of the instruments of government in ways that Margaret Thatcher didn't. Aided by a reformed Treasury and a large, active Cabinet Office, Blair runs government from the center, with the numerous components expected to fall into line. To be sure, Blair's interests lie in policy-and-results, but he knows that services connect the two. He, therefore, does not want agencies going in their own direction. While he has little interest in operating detail, he does want to ensure that agencies operate in accord with his policies to produce the intended results.

In moving to tighten policy control, Blair may have addressed a difficult constitutional issue that troubled his predecessors. If agencies are operationally autonomous and the responsibility of their chief executives, who answers when things go wrong? One such breakdown occurred in the mid 1990s and led to dismissal of the Director General of the Prison Service (a Next Steps agency) and to confusion as to where the line should be drawn between the minister and the chief executive. Following some embarrassing breakdowns in prison discipline, the Home Secretary pressured for the dismissal of one prison head, despite opposition from the Director General. But when questioned on this matter before a parliamentary committee, the Home Secretary insisted that the decision had been made by the chief executive, because it was an operational matter. He defined the relationship between himself and the Prison Service as follows: "I am responsible to Parliament for policy. The Director General... is responsible for operational matters."(Quoted in Lewis 1997, p. 171.)

The new formula resolves this by placing all final responsibility for performance in the minister. Actual performance is to be valued more than autonomy.

6.2 New Zealand: Government by Contract

New Zealand's reforms were contemporaneous with Britain's, but it acted through legislation rather than administrative rules. Two laws – the State Sector Act 1988 and the Public Finance Act 1989 – sought to reorient public management from the control of inputs to accountability for outputs. The first replaced all career department heads with chief executives recruited on a competitive basis and employed under term contracts that specify their responsibilities and the matters for which they are accountable. It makes the chief executive responsible for all departmental operations. The second shifted the budget and appropriation from inputs to outputs, thereby converting these actions into implicit performance contracts. The combined effect of these and other reforms has been to decouple the policy work of ministers from the operational responsibility of chief executives.¹⁰

The restructured departments are to New Zealand what Next Steps agencies have been to Britain - self-managed units empowered to run themselves. The parallel is not fully justified, however. First, British agencies have sharply defined missions while New Zealand departments have a portfolio of responsibilities. Moreover, New Zealand has fewer than 40 departments, only about one-third the number of British agencies. Second, New Zealand has a large number of Crown entities - non-departmental bodies - that lie outside the regular organizational structure. Accountability of these entities is less well established than that of departments, generating problems that recent governments have had to confront. Finally, the Next Steps model relies on the skills, commitment, and professionalism of agency managers to improve public performance. NZ also relies on managerial capacity, but goes much further by constructing a network of contracts that purport to obligate managers to specific performance. In one relevant feature, however, the parallel holds. In New Zealand, as in Britain, the initial objective was to separate policy and operations, but recent governments have sought to curtail agency autonomy.

¹⁰ For a fuller account of these and other NZ reforms, see Schick (1996).

The components of the NZ model

Why did NZ entrust operational authority to managers but then not trust them to manage performance unless they were bound by formal contracts? A big part of the answer is that the NZ model was based more on economic doctrine than on evidence of managerial behavior. The architects of the NZ reforms were schooled in a dogmatic version of principal-agency theory rather than the more eclectic view suggested in chapter 3 above. They were convinced that opportunistic civil servants use their informational advantage to undermine the political leaders they nominally serve. This mindset suffuses *Government Management*, a remarkable document prepared by Treasury for the incoming government in 1987. It argued that government is vulnerable to "producer capture" because of the conflicting objectives that arise from the combination of policy advice provision and policy implementation within the same organization. It recommended that policy advice and service delivery be placed in separate organizations. For example, the Ministry of Defense was split into two departments, one responsible for policy, the other for military operations.

NZ reforms linked policy makers and service providers by formal contracts. These include individual employment contracts for senior and middle managers, performance agreements for department chief executives, purchase agreements that specify the outputs to be supplied by departments to ministers, and statements of intent between departments and Crown entities. These contracts are supported by estimates which detail expenditures by output classes, departmental forecast reports (tabled with the annual budget) that inform Parliament of services to be provided, performance targets and measures, annual reports, and audited financial statements. Several features of these contracts provide insight into how NZ promotes performance and accountability.

? The contracts specify outputs; they do not deal with inputs. In the typical contract, one party provides resources, the other agrees to provide services. The contracts do

not specify outcomes because these may lie beyond the direct control of the contracting parties.

- ? The contracts are bilateral, between a principal and an agent – between a chief executive and the minister, or between the chief executive and a senior manager – even when the government has an interest in the matter.
- ? The contracts are within government, between one entity or official and another, or between elected officials and managers. In addition to these internal contracts, the government writes commercial contracts with external suppliers.
- ? The same person or office may be a principal in some contracts and an agent in others. For example, chief executives are agents in their performance agreements but principals in negotiating employment contracts with senior managers in their departments.
- ? An official may negotiate multiple contracts covering different aspects of his/her performance. Thus, if a department supplies outputs to several ministers, its chief executive negotiates a separate purchase agreement with each.
- ? The contracts vary in specificity, but none disaggregate outputs into discrete units or specify unit prices, as is done in commercial contracts. In most cases, the contract specifies that a sum of money will be exchanged for a class of outputs. Some contracts specify the key results or actions to be taken in fulfillment of its terms.

New Zealand has taken extraordinary measures to replicate critical elements of private contracts. The paragraphs that follow go through these elements of the annual purchase agreements between ministers and chief executives.

Arms-length relationship: How does government contract with itself? In NZ, the answer is that it splits itself into distinct entities, each free to pursue its interests in negotiating and enforcing the contract. Department chief executives are employed by the State Services Commission (on behalf of the Government), not by the minister; thus, they are not so beholden to the minister that they cannot act independently.

But is the relationship truly arms length? One problem is that ministers have two conflicting roles: they are both purchasers of outputs and owners of departments. As purchaser, the minister wants to get the best bargain by driving the price down. As owner, the minister wants the price to be high enough for the department to be in robust financial condition. Chief executives also have two conflicting roles: as department heads, they want to be independent; as government employees, they are dependent on the confidence of the minister. When they discuss the terms of a purchase agreement, minister and chief executive are interdependent, not at arms-length.

Ministerial discretion: It makes no sense to rely on contracts if the parties to the agreement have no choice but to accept the terms offered them. In NZ, appropriations are made to ministers who may use the funds to obtain services from their own departments or from alternative suppliers. All services are contestable, that is, subject to competition, even core activities such as policy advice. Contestability enables a minister to seek more favorable terms in contracting with departments. There is a big difference, however, between theoretical and actual contestability. It is one thing for ministers to have authority to select alternative suppliers, quite another for them to go outside government for basic services. In fact, ministers purchase most services from their own departments.

Departmental Discretion: There would be little gain in contracting if departments had no choice in how they operate. New Zealand chief executives however have discretion to use departmental resources as they deem appropriate. They can deploy staff, organize work, and spend money free of constraining civil service rules and other administrative controls.

Output Specification: A valid contract has to specify what is being exchanged. Object classes, representing broad groupings of activities, make up NZ budgets and appropriations. These are more finely itemized in annual purchase agreements that

specify the work to be done. In contrast to performance targets which isolate a few matters for special attention, New Zealand's contracts cover a department's total output. It is unusual, however, for these contracts to cover the volume of work, for example the number of applications processed or persons treated in health clinics.

Cost Specification: A purchase agreement specifies the amounts to be paid to the department by the minister. It typically specifies a payment for all the work to be performed, though it sometimes singles out particular activities. The contract is for a fixed amount, and is not broken down into unit prices. Thus, the amount paid does not vary if actual output is more or less than the contracted amount. Because the budget and appropriations are on an accrual basis, the purchase agreements cover the full cost of services, including depreciation, a charge for use of capital, and goods and services tax.

Performance review: Performance under the contract is monitored through periodic meetings between the minister and chief executive, progress reports, annual reports comparing actual and agreed outputs, and audits which assess the reliability of the information in annual reports. In NZ, a qualified audit is regarded as an indication of material deficiencies in departmental management.

(Lack of) effectiveness of contracts in enhancing accountability

The foregoing paragraphs show that NZ has made extensive and creative use of contracts. But one should not therefore conclude that agreements within government have the same effect as those negotiated in private relationships. The main problem is that even though government purchasers (ministers) and providers (departments) may be institutionally separate, they often are locked into an interdependent relationship in which each side may feel pressured to defer to the other side's interest rather than look after its own. After all, the minister and the government bear much of the political cost if the department fails to perform according to the terms of the contract. For example, politicians may be blamed for the failure of the education system. It is often the case in

these relationships that the more wasteful spending agencies are, the more government is impelled to spend on them.

In contrast to contracts executed in real markets, government has little recourse for failure to perform. It does not gain much leverage by having the option of canceling or stopping payment. The prospect of sacking public employees may do more damage to the ambitions of ministers than to the purses of the employees. Converting bureaucratic relationships into contractual ones does not mitigate principal-agent problems.

During negotiations, ministers typically know less about the outputs they are buying than managers know about what they are selling. In many departments, the chief executive presents a draft purchase agreement to the minister who signs it after making a few marginal adjustments, such as adding a report on a particular matter. To redress the imbalance, some ministers have engaged independent consultants to serve as purchase advisors during negotiation of the agreement. But even when this is done, the minister merely adds or changes a few items to reflect his/her interest.

The contestability of contracts gives government some leverage in employment contracts but not in the purchase agreements. Chief executive positions have been filled on a competitive basis, and candidates from outside government have stood a good chance of being selected. If the minister is dissatisfied with performance, the chief executive will be persuaded to step down or to take another post. Contestability on the purchase of outputs, however, does not give ministers much leverage. Although they have legal authority to outsource virtually all activities, in practice government departments and agencies still provide basic services.

From the perspective of ministers, there are several compelling reasons for relying on in-house suppliers. One is that outsourcing might compel the dismissal of many civil servants, another is that the ministers have even less control over the outside contractor than over the department; a third is that ministers may be exposed to more blame if

outside entities fail to perform. In an unusually forthright critique, the State Services Commission has poked huge holes in the government by contract approach. Referring to purchase agreements, it concluded:

The model is that of the marketplace: buyer and seller haggling over price against a backdrop of competitive supply, discriminating demand, efficient price, symmetrical information and minimum transaction costs. Experience has shown, however, that none of the model's conditions can be reliably satisfied, even in a weak form, in the NZPS. The market for NZPS outputs is characterized by monopoly supply, compliant demand, arbitrary price, asymmetry of information and time horizon, and significant transaction costs, many of which arise well after the transaction. The concept of an efficient market fundamentally misrepresents the nature of NZPS production and Exchange. State Services Commission (1998), p. 10.

The pretense that purchase agreements are genuine contracts adversely affects managerial performance. In New Zealand, chief executives and senior managers maintain a checklist of the work specified in their contracts as a means of measuring their performance. Rather than taking a broad picture of how well the organization is performing or what it is producing, they concentrate on the checklist, taking care to show progress on the items in it while ignoring matters not listed therein.

In the view of New Zealand politicians and managers, the contracts have enhanced performance not because of their terms but because they provide opportunities to discuss matters of mutual interest. The process of drafting a purchase agreement encourages the minister and chief executive to discuss what they hope will be accomplished in the period ahead, and how to deal with problems that stand in the way of achieving agreed objectives. The parties to the agreement meet periodically to review progress and make appropriate adjustments. This compels ministers to set aside time on the calendars to meet with chief executives, and chief executives have to accommodate the concerns of politicians in their work programs. The contracts deepen and regularize the relationship, but despite the formalities neither side regards them as real contracts.

Integrating the public sector

NZ's contractual model has extraordinary cohesion. The elements fit together in ways that make it difficult to remove one part without disabling others. Output based accountability has survived several changes in government and a fundamental shift from first-past-the-post elections to a form of proportional representation and from majoritarian to coalition governments. Yet, there have been significant accretions to the model during the past decade, mostly by way of strengthening its accountability mechanisms. NZ takes accountability seriously, and it has been willing to add requirements that plug in perceived gaps in the original design.

Two fissures have opened up, however, and these have given rise to fresh proposals for tinkering with the model. One is the weak collective capacity of the government to define objectives and priorities; the other is the proliferation of Crown entities (CEs) outside the departmental structure. Both affect the cohesiveness of the state sector, the capacity of elected leaders to share public policy, relations between politicians and managers and effectiveness of the accountability regime. Each has prompted some adjustments in NZ public management, but more fundamental changes may emerge in the future.

Strategic Capacity: It is now widely accepted that the original design had an inadequate and flawed conception of the overall public sector. It makes ministers responsible for outcomes and chief executives responsible for outputs. Both parts of this formula are misconceived. On the one hand, ministers get involved with outputs in their role as purchasers; on the other hand, departments through their actions and in-actions have significant impact on social outcomes. The formula has no mechanism dealing with outcomes comparable to that for outputs. The budget and appropriations are made by output classes, a web of contracts pertain to outputs, and accountability is viewed predominantly in terms of the provision of output. It should come as little surprise, therefore, that outcomes are the stepchild of NZ reforms. Add to this that no provision is

made for *ex ante* specification of priorities through strategic plans or other means, or for *ex post* assessment of results through program evaluations or similar methods.

The difference between outcomes and outputs is not only that one deals with effectiveness and the other with programs, but that outcomes require that work be framed broadly in terms of policy and objectives, while outputs are narrowly defined in terms of the work of a single entity. Outcomes broaden one's perspective to that of government or society, outputs narrows it to that of a single department. In the early years of NZ's reforms, there was considerable apprehension within government that what New Zealanders call "the collective interest" was being slighted by the output orientation. That this did not occur was partly due to the country's small size and geographic isolation, and partly to the zest with which reformers took to their new tasks. Networks formed rapidly, bonding chief executives into a group that met often to discuss developments, and managers interacted easily with politicians. But as the reforms matured, the lack of policy glue to bond together the government's various production units came to be seen as a serious deficiency.

Fixing the problem has not been easy because it occurred not by inadvertence but by design. It derived from the strong emphasis on operational efficiency and accountability and from the sharp distinction between the political accountability of ministers and the managerial accountability of chief executives. In the early 1990s, the Government sought to remedy this deficiency by adopting strategic result areas (SRAs) - broad policy statements - and key result areas (KRAs) - more specific statements of the actions to be taken in the medium-term to implement its policies. The Government viewed the SRAs as link between its "long-term objectives and the operational activities of departments. They aim to bridge the gap between the broad vision of a future New Zealand...and the one-year focus of existing departmental budgets and chief executive performance agreements."¹¹

¹¹ Prime Minister's forward to the 1994-1997 SRA, Quoted in Schick (1996), p. 55.

The key result areas resemble work or activity measures, and progress toward achieving them is expressed in terms of observable milestones which specify the results expected, target dates, and the quantitative or qualitative standards to be achieved. Departmental budget requests and government decisions are classified in terms of the SRA's they serve, while KRA's are distilled into the annual performance agreements for chief executives.

Few adjustments in the NZ model have been as favorably received as the SRA's/KRA's. Ministers like these measures because they can more easily align their priorities and budget requests to the government's objectives. They use SRA's as talking points in support of budget bids and to demonstrate that they are responsive to the government's aims. Chief executives welcome this system because they have a clearer indication of what is expected of them and they can organize operations to show progress relative to the KRA milestones.

Despite the perceived success of the SRA's/KRA's, there is widespread agreement that strategic aspects of public management still are given inadequate attention. A recent review of assessments of the NZ reforms commissioned by the Treasury found that the government had not succeeded in aligning outcomes and budget decisions or in linking outputs to outcomes.

Efforts to improve the specification of outputs over recent years have largely failed to resolve the problem that most, if not all departments and agencies are still unable to draw a strong connection between their outputs and the resulting impact on Government's policy objectives. One consequence of the perceived 'policy failures' arising from this alignment problem is that departments or agencies, in the understandable interests of showing policy results, may bypass the output/outcome relationship altogether by defining new and/or additional policy objectives outside the outputs/outcomes framework. (Petrie & Webber 2001, p. 17.)

Other management experts have suggested that remedying NZ's strategic deficiency may require a shift from output to outcome budgeting; allocations would then be made

in terms of strategy or program rather than by output class. (Ibid.) In our view, an even more fundamental shift may be required — making chief executives as well as ministers responsible for outcomes.

Crown Entities: In NZ, accountability for resources and results is centered on the roles and relationships of ministers and chief executives. Their respective responsibilities are spelled out in law and reinforced through contracts for outputs and reports on performance. Departments, however, account for significantly less than half the money that goes through the State budget. Most funds are actually spent by Crown entities, non-departmental bodies that are outside this accountability structure. At present, there are approximately 70 Crown entities, plus another 2,600 school boards. These Crown entities differ from departments in a number of important features:

- ? They are not legally part of the State, but are corporate bodies acting in their own name.
- ? A board appointed by the Responsible Minister typically governs crown entities. The board, not the Minister, appoints the chief executive and is the CE's policy making body.
- ? Each Crown entity is established by legislation that defines its relation to the Responsible Minister, its duties and responsibilities, and the manner in which it is to operate. Consequently the Minister's role *vis-à-vis* Crown entities is not standardized, as it is in the case of departments.
- ? In contrast to departments, Crown entities do not have a common monitoring regime, and some have acted as if they were totally independent.

Although they share a common label, the Crown entities are not homogeneous in either form or function. Some are outside the departmental structure because they have regulatory functions, some because they were de-coupled from departments in order to separate policy from operations, some because they have always been non-

departmental, some because the government wanted stakeholders to have a voice in their operations.

Crown entities are subject to their own accountability regime which includes the preparation of a statement of intent spelling out their plans for the year ahead and an annual report. Studies undertaken in 1999 and 2000 by the State Services Commission and the Treasury found serious shortcomings.¹² These include:

- ? extravagant expenditures (on travel and payments to board members);
- ? lack of a public service ethic;
- ? uneven and inadequate monitoring by departments and inattention by ministers to the Crown entities for which they are responsible;
- ? absence of standard procedures for appointing board members;
- ? unresponsiveness or disregard by Crown entities to Government policies;
- ? inadequate governance arrangements and confusion over the legal status of some Crown entities;
- ? ad hoc procedures and criteria for designating organizations as Crown entities rather than as departments or State-owned enterprises;
- ? incomplete and inconsistent accountability requirements, and contradictions between the enabling statutes of some Crown entities and the Public Finance Act.

Remedying these deficiencies has been difficult because Crown entities are so disparate that different formulas are needed. The State Services Commission has proposed that Crown entities be divided into four distinct categories, with different accountability arrangements for each.

¹² The State Services Commission has published a series of papers on Crown entities, including: “Crown Entities, Role of Ministers, Crown Entities and Department: (Occasional Paper No. 18, 1999); “Crown Entities: Review of Broad Appointment and Induction Processes” (Occasional Paper No. 20, 1999); and “Crown Entities: Organisational Design,” (Occasional Paper No. 21, 1999).

- 1) Crown Companies would be entities that carry out commercial activities; these would be governed by the Companies Act rather than by laws pertaining to State organizations.
- 2) Independent Crown Entities would be established for activities where there is a compelling reason to be free from ministerial influence. NZ examples include the Electoral Commission, the Accounting Standards Review Board, and the Policy Complaints Authority. These entities would be permitted to act without giving effect to or having regard for the policies of the Government of the day.
- 3) Autonomous Crown Entities would not be the appropriate form of organization in situations where the low strategic, political or fiscal risk enable the government to delegate in respect to the activities undertaken by the entity. In these cases, the Responsible Minister retains authority to set operations performance expectations, such as the quantity, cost and quality of services to be provided. Examples include the Casino Control Authority and the Lotteries Commission.
- 4) Crown Agents are the appropriate organizational form when a high degree of ministerial control is wanted. In these cases, the entity operates as an agent of the Crown even though it is legally independent. Crown entities that may fit this category include the Civil Aviation Authority and the Land Transport Safety Authority.

Legislation recognizing this classification has awaited Government action for more than a year, leaving the legal status of Crown entities in limbo. It appears that the heterogeneity of Crown entities and political considerations have complicated the task of settling this matter through legislation. Despite this inaction, the State Services Commission senses “a sharper focus on governance and accountability matters, both by departments and the Crown entities themselves, and an apparent willingness to accept the need for change and the resolution of outstanding problems. (State Services Commission 2000).

6.3 Conclusions

Both the UK and NZ reforms represent attempts to strengthen accountability. The two countries have followed somewhat different routes; the NZ has applied an orthodox economic paradigm carried to the limit, whereas the UK has worked along more classical lines. Next Steps has been characterized by a parliamentary committee as the most ambitious management reform of the past century, and there is widespread agreement that it has brought significant gains in operational efficiency and service quality. Despite the fact that Conservative governments launched it, the Labor government headed by Tony Blair continued Next Steps.

As the previous discussion shows, the experience in both countries is not entirely positive. The problems of principal and agent are inherent to the situation and cannot be resolved once and for all by whatever administrative device. Nonetheless, there is reason to believe that the serious attempts in both countries to strengthen accountability are models to be followed, and that the experience accumulated, judiciously used, can be of value to other countries.

Britain created agencies to liberate service providers from the shackles of an overbearing Whitehall; New Zealand was determined to free policy makers from capture by providers. The former relies on sharply defined performance targets, the latter on formal contracts.

These differences aside, both offer an important lesson for Sweden. Accountability must be built into the work of agencies and into relationships with government and ministers; it cannot be taken for granted or be an afterthought. The UK and New Zealand have invested much more in accountability than Sweden has, and both pursue it more systematically and with more vigor. In both countries, performance and accountability are negotiated between ministry or department and agency. Accountability inheres in

the relationship. This does not assure that the relationship is smooth or productive, nor does it assure performance.

Chapter 7 The unbalanced dialogue

7.1 Governance by dialogue

Rather than integrating policy and administration, Sweden has over the years decoupled them. It has favoured administrative due process over policy coordination. A large number of free-standing agencies, independent from the Chancery and from one another, have a history that goes back to the 17th century. Today this results in a fractured organisational map, with approximately a dozen ministries at the top and hundreds of agencies below.

The Instrument of Government is silent on most aspects of the boundary between policy and administration, but it does secure the organisational independence of agencies in important respects. But the relationship is inherently more characterised by interdependence than by true independence. Each party to the relationship has something the other wants. The government has money and authority to change agencies or their activities; agencies have information and perspective as well as the organisational resources to carry policies into effect. Interdependence impels the two sides to interact and cooperate on a regular basis, with each supplying some of the things that the other needs.

Agencies therefore operate in a twilight zone between independence and compliance. They generally have enormous discretion in operating the program entrusted to them, and many play an active role in shaping new policies and in advising the government on how existing programs should be designed. But agencies also receive numerous instructions from ministries each year. Some have government-wide application; others pertain to a particular program or agency.

As interdependent entities, ministries and agencies rely more on discussion and consensus than on formal negotiations and decisions. Each side brings to the table the matters it wishes to discuss, but they seldom have serious disagreements on how to handle particular issues. And if neither party wants an issue to be discussed, it is not dealt with before external pressure induces them to handle it. Their mutual understandings and expectations are reflected in policy guidance, budget actions, legislation and various communications. The Issue Letter is often a product of these discussions, but one side or the other does not dictate its terms; when the letter is written, it faithfully records the understandings that were previously reached.

Participants in this relationship commonly refer to it as a dialogue — the exchange of ideas and information through ongoing, mostly informal, contact between people who deal with one another across a range of issues on a continuing basis. The word dialogue as it is used in Sweden describes how policies and objectives are set, budgets are formulated and problems resolved. Dialogue fits the process by which the Issue Letter is prepared and performance targets are specified. It has been used over the years to relax the rigidities of line item budgeting, civil service rules, and other administrative procedures. It gives agencies more managerial freedom and ministries more useful information than if they had proceeded along formal channels. Dialogue conveys a more casual relationship than one in which the ministry prescribes and the agency complies. It suggests a certain parity in the relationship rather than the hierarchy embedded in formal ministry-agency interaction.

In this dialogue, neither side is fully in charge or fully compliant. Each seeks to protect its salient interests. Agencies want operating freedom, ministries want their priorities implemented. To have operating freedom, agencies seek discretion to spend as they see fit; to control priorities and programs, ministries seek information on what agencies are doing and the results ensuing from their activities.

Participants in the relationship often have difficulty explaining what is discussed or how decisions are made. It sometimes appears that the relationship is more important to them than the concrete results flowing from their interaction. This concept of dialogue is strikingly similar to what was termed *relational contracting* in chapter 3. Relational contracting emerges when parties are motivated to behave in a trustworthy and cooperative manner because they expect the relationship to continue. It ascribes roles and obligations to the respective parties, rather than specifying contractual terms that can be brought to court in order to ascertain compliance. It stabilises expectations as to how the parties will perform and, in the case of government, complements formal contract-like arrangements specified in budgets, legislation, and administrative regulations.

In contrast to a formal contract, which is for a discrete period and for specified performance, a relational contract is ongoing, and some of its key terms may only be implied. A relational contract continues as long as the parties continue to interact on the same basis as they did previously. Relational contracts fill in the details of the relationship and compensate for the incompleteness of formal contracts. They enable the parties to adjust to new or unforeseen circumstances without having to rewrite formal contracts.

Relational contracting is prevalent in all effective budget processes. Although many governmental activities involve either ministry or agency, budgeting entails interactions of both. Budgeting is one of the key processes, some would say the most important, in defining the relationship between ministries and agencies.

It is useful to think of budgeting as consisting of two parallel but distinct contracts. The budget is a formal contract that specifies financial resources, how these are used, and (in some governments) the activities to be conducted or the outputs to be produced. Budgeting also is a relational contract that ascribes mutual obligations and roles to the

participants. The two types of contracts coexist, for whether as a document or as a process, budgeting would be inadequate if it were based on only one or the other.

In governments that have line item budgets, as once was the case in Sweden, the formal contract specifies and limits what may be spent on the various items of expenditure such as personnel, supplies, utilities and travel. The more detailed this formal contract is, the greater the restrictions it imposes on spending units. But as itemised as these budgets may be, they nevertheless are incomplete and vulnerable to self-interested opportunism by spenders. Inasmuch as they are prepared long before expenditures occur, line item contracts cannot anticipate changes in organisational needs, such as increases in the cost of various items. During implementation of the budget, either side may also manoeuvre to alter some of the contract terms. The finance ministry may withhold some appropriate funds, or spending units may use their funds for purposes not authorised in the budget. They may even spend more than was appropriated in the expectation that the government will be compelled to give them more money.

Each party to the formal budget contract has advantages and weaknesses. The central party has a great deal of formal power but inadequate information on program needs and on how authorised funds are actually spent. Agencies have an advantage in information, but lack the formal authority to get all the resources they want. Spenders and controllers are interdependent; each has what the other covets. They compensate for what they lack by filling in the details of the budget contract through frequent contact in which money and information are exchanged. This informal contract is as pervasive as is the formal contract.

The concept of relational contracting fits the realities of budgeting. The cyclical routines of budgeting, with the same procedures repeated year after year by the same role players (while not individuals) generate trust and cooperation. Spenders want their bids to have credibility and to be treated favourably by central authorities. They do not want the inevitable cuts made by the finance ministry to fall on high priority items or to impair

their capacity to carry out authorised activities. For its part, the finance ministry wants to produce a defensible budget that constrains spending without stirring up political difficulty or impairing the agency's ability to do its job. A forthright exchange of views and information enables each side to do its job better. It is quite common for ministries to base their budget decisions on advice from agencies on where cuts can be safely made, and it also is common for agencies to base their budgets on advice from central controllers. Although the relationship appears to be adversarial, beneath the surface abrasions of the process, the two sides cooperate. Trust is at the core of the relational contract.

The logic of relational contracting is not only present when the budget is prepared. After appropriations have been voted, the dialogue introduces a measure of flexibility into what might otherwise be a rigid process. Many situations that make it necessary or desirable to deviate from the budgeted amounts arise in the course of the year. Often, these variances are negotiated informally, without altering the formal budget through virement or similar procedures. Although major adjustments are sometimes formalized, many more are implemented through informal understandings.

Relational contracting counteracts some of the standard problems in principal-agent relations. In particular, it explains how agents and principals cooperate even when their interests diverge. Principal-agency theory points to the problems of the relationship; the relational contracting concept shows how it still works. It thus underpins the logic of policy ministries and independent agencies engaged in an outgoing dialogue. For generations, this dialogue enabled Sweden to muddle through the policy-administration boundary problem. The solution was not always clear or consistent, but it enabled ministries and agencies to work together in a reasonably effective manner.

The Director General of Swedish agencies is used to make the informal relationship work. In particular, the habit to select agency heads with a political background is a means to ascertain that the rules of the relational game are adhered to. In this, the

political background of the officials is not a deliberate purpose to proliferate certain political ideas. Rather, it is a covariate with the position at the centre of political decision-making.

In government as in markets, relational contracts have both advantages and deficiencies. The positive aspects have been emphasised; this way to interact compensates for the inherent incompleteness of the budget and other formal documents, it builds trust and understanding among parties whose interests are both adverse and interdependent, it establishes expectations and obligations and it reduces transaction costs. But relational understandings are not full substitutes for formal contracts. First, informality diminishes transparency in budgeting and other government actions. It has repeatedly been observed how the documents that formalise programmes or decisions are preceded by repeated interaction between all involved parties, making it *ex post* difficult to hold anyone to account for the outcome.

Second, the consensus atmosphere surrounding the maintenance of relational contracts hampers the critical discourse. Third, the absence of formal and explicit analysis jeopardises welfare. Actions that benefit the parties to the relationship at the expense of a broader public interest will tend to become more frequent. In conjunction with the logic of political decision-making, the costs may be very large. When decisions imply costs for many but in small sums for each, the political interest in these costs is small. By contrast, negative consequences for small and easily pinpointed groups may block decisions that would benefit the many. Such changes could possibly be implemented by designing intelligent bribes to the losers, but this is blocked by the unavailability of analytically trained experts at the ministerial level. This is the well-known logic of free riding incentives in public-good like situations. Relational contracts in force in Sweden's central government strengthen these perverse incentives.

The political logic implies that pending decisions are analysed more to understand their political implications than their financial and economic consequences. The everyday

logic of ministerial decision-making is to identify winners and losers rather than to ascertain that the decision is beneficial to society as a whole. The nature of the relationship between principal and agent gives agency representatives poor reason to inform the decision-makers about obvious flaws in these respects.

In this sense central government is also based on the need to uphold consensus between the parties. The absence of formal tools for performance analysis illustrates this feature; rather than running the risk to establish that one performs less good than another, it is more convenient to rely on methods that find some positive indications of performance with everyone. And for agencies it becomes more important to refrain from taking an incorrect decision than to search for the correct way to deal with a problem.

7.2 The absent ministry

The dialogue between ministries and agencies was for long conducted by persons who had a common outlook on the role of government and cooperated in stretching the boundaries of the welfare state. In annual budget negotiations they discussed where incremental funds should be spent, which programs should be initiated or expanded, how many staff should be added, and so on. The dialogue was also carried on through ad hoc commissions established to deal with one or another problem to recommend solutions, usually in the form of new programs. The dialogue generated little friction, commissions supplied the information needed to justify expansion, and annual budgets supplied funds to pay for new or improved programs.

The changes implemented during the 1980's and 1990's were intended to fundamentally change the dialogue between ministries and agencies. Rather than argue over operational issues, they would discuss the results achieved in the recent past and those planned for each of the next several years. Underlying the technical revisions of the budget process was the expectation that the dialogue would deal with outputs rather

than inputs and with big policy issues rather than with incremental adjustments in funding levels.

The reforms were prompted by gradual changes that over the years had tilted the balance between the parties, but only part of the reform agenda proceeded according to blueprint. Agencies obtained operating discretion, but the multi-year frames did not open the budget to a deeper dialogue on results. For the reorientation to occur it is necessary that ministries have the capacity and interest to instruct agencies on what was expected of them. Ministries however have difficulty specifying objectives and what they expect by way of performance. Linking resources and results has therefore proved to be a difficult assignment. The most entrenched problems are rooted in shaky assumptions about how the two sides would behave once spending details were purged from the dialogue. In particular, the reformers lacked a clear idea about the nature of the relational contract that lies at the heart of the relationship.

In preparing their budgets, ministries have had difficulty formulating policy guidelines or raising basic questions, and agencies, though they produce much performance information, have not undertaken the probing assessments that may have called ongoing programs or their continuing existence into questions. Ministries face a number of impediments in performing their new role. One is that the senior staff concentrate on political and policy work — in particular Cabinet business, pending legislation, and relations with other ministries. In the typical ministry, no senior person is responsible for overseeing the agencies. Some ministries assign this work to junior staff as a form of on-the-job training. To make matters worse, the size imbalance between ministries and agencies often leave the former with insufficient information on what the latter are doing.

Although ministries have authority to dictate performance targets, they rarely do so. Instead, agencies usually select their own targets, and they also have a major role in defining policy objectives and proposing change. This aspect of the ministry-agency

relationship under the reformed system is illustrated by the words of a government report:

The dialogue between the Government and its agencies and the responsibility of the management of agencies to follow-up results, review and improve the efficiency of their activities are the core elements in management by objectives and results. The responsibility for developing the management by results system and introducing regular and effective follow-up thus rests on the agencies themselves.¹⁵

Nothing is said here about the role of ministries in this dialogue. Their role is secondary.

Results-oriented budgeting has been a procedural success. In accord with the reform, just about all agencies now have frame appropriations covering operating expenditures. There has been a reduction in the amount of administrative detail crammed into the annual budget bill. Prior to the reforms, the document ran to about 2,500 pages; it is somewhat slimmer now, despite the addition of some material on objectives and results.

Nonetheless, common to the formal documents of the budget process is that they describe activities to be carried out, such as special projects or studies, rather than the results to be achieved. The budget documents rarely set forth the concrete measures by which agency performance will be assessed. The instruction to undertake special studies has become so common that these effort occupies much of the daily work at agency offices. Often, the reports submitted to the parent ministry leave little or no trace in documents subsequently produced there. In this sense, the management reform is a policy failure.

In 1992, the government sought to encourage a results orientation in the budget process. The budget bill filed that year declared that the annual report prepared by each agency should “be given greater prominence and should also be regarded as the natural report-back document for results analysis.” An annual report contains both financial statements

and statements on the results of operations. Both types of statements are subject to audit, but audit practices are much more advanced with respect to financial than performance data.

Regardless of their content or quality, annual reports cannot compensate for the failure of results budgeting. Whereas official documents assumed a dialogue between ministries and agencies, annual reports resemble a monologue, in which agencies report on their achievements in a favourable light. As long as ministries do not take their part of the task seriously, the prospect for change is bleak.

7.3 The UK or New Zealand?

Is the independent agency model so flawed that Sweden should consider far-reaching changes in governmental structure, or can the problem be ameliorated within the existing ministry-agency structure? The purpose in raising this question is not to suggest that Sweden should dismantle constitutional arrangements that have served it for centuries, but to explore why the agency model is reputed to work elsewhere, particularly in the UK and New Zealand. These two countries have based their contemporary reform strategies on establishing (or reorganising) entities that have operating freedom from the ministries to which they are responsible.

Several critical distinctions emerge in comparing Sweden to the UK and New Zealand. In Sweden, agency independence rests on the juridical principle that administrative due process should not be impaired by political intervention; in Britain and New Zealand independence rests on the managerial principle that performance improves when managers have discretion to operate as they deem appropriate and are held accountable for results. While Sweden has organised the relationship to proscribe interference, the other countries have done so to enhance performance. The New Zealand and British

¹⁵ Ministry of Finance, Management of Government Administration and Financial Conditions for State

models are built on the expectation that ministers and other policy makers will play an active role in guiding agencies and overseeing their performance. Rather than being regarded as interlopers if they intervene, policy makers would be regarded as negligent if they did not closely monitor agency actions.

A second difference emerges from the differences in principles of design. Sweden has small ministries because it assigns them a small role vis-à-vis agencies and guards against undue intervention; the UK and New Zealand have much larger central organs (relative to the size of operating agencies) because they are expected to be active policy makers and performance reviewers. Moreover, in the UK and New Zealand, agencies have been created by de-coupling operations from ministries; the ministry decides on the residual staff and other resources that it will retain when the new organisation is in place. In Sweden, agencies have been created independently of ministries and without regard to what resources and capacity should be retained in central government.

A principal objective of Sweden's management reform was to impel ministries to take a more active role in discussing performance expectations and reviewing results. The reform was less clear on how specific ministries should be in prescribing performance targets. In fact, the language of targets is generally avoided. Instead, performance was to be the focus on the ongoing dialogue between ministries and agencies. Britain and New Zealand, by contrast, predicated the relationship on the explicit, formal specification of targets, against which actual performance was to be compared each year. In both countries, performance was to be the driver of the new relationship, not a by-product of it. From Sweden's perspective, the British and New Zealand approaches unduly narrow the scope of performance; from Britain's and New Zealand's vantage point, the Swedish approach is too diffuse and unfocused.

In terms of actual performance, there is no basis for concluding that one country's agencies are better managed or more productive than that of the others. But there does appear to be a strong indication of that governing organs in Britain and New Zealand have a better-defined role and more ample resources to prescribe the activities that their agencies carry out, and to evaluate the results.

It would be premature to assess the durability of British and New Zealand agencies or their contribution to modern governance. New Zealand's reforms have stirred up more controversy because of their heavy reliance on contract-like arrangements. There is some early indication that neither country has fully resolved the manner in which agencies connect with ministries. Both have highly publicised breakdowns and stresses in the relationship, but so has Sweden. These exceptional cases suggest that much additional work has to be done in defining the ministry-agency relationship; there is no blue-print.

8. Summary and conclusions: Getting the relationship right

8.1 A historical flash-back

Among the 17th-century documents kept by the Swedish National Archives is a proposal for a working instruction for the Government Chancery, dated April 1654. The author of the document is Schering Rosenhane, a senior deputy in the chancery, and the proposal was elaborated originally at the request of Queen Christina¹³. Rosenhane was anxious not to come into conflict with Chancellor Oxenstierna however, and the analysis and recommendations doubtless reflect the views of the latter. Oxenstierna was the dominant figure of Swedish politics during the first half of the 17th century and is rightly called the father of the Swedish administrative model, laid down in the constitution of 1634.

Rosenhane's memorandum is in reality an evaluation of this administrative model, based on the experiences from the first couple of decades. Its conclusions are clear and in some respects noteworthy. The Chancery, which according to the 1634 constitution was at the same level as the '*collegia*' (today's agencies), is proposed to be given far-reaching authority over the colleges. More precisely, the Chancery should be given the right to intervene in any matter formally under the responsibility of the *collegia*. Given its formal control of the execution of royal decisions, this amounted to veto power in the central administration. Further, a group of information officers were to supply the Chancery with the information necessary for surveillance of the activities of the colleges.

In plain words, Chancellor Oxenstierna, the architect of the new central administrative structure, was clearly dissatisfied with its performance during its first decades. Power had been diluted and needed to be re-concentrated at the Chancery by means of an intelligence and analysis unit and a formalised right to veto decisions taken by the *collegia*.

The proposal was never implemented. The structure of the Swedish central administration remained intact and developed according to its own logic during the next 350 years. Many things have happened during these years, but it is nonetheless striking that the diagnosis presented in the current report in many respects is similar to that of the 1654 memorandum.

An obvious argument against reform today would be that if the system has worked for three and a half centuries, why change it? The first answer is of course that all administrative structures can be improved, and that the fact central government has delivered something is no proof that it could not deliver more or better. More importantly, the world has changed. After the Second World War, the speed of transformation has increased noticeably. Some of the most conspicuous changes are the following.

The public sector has increased in size and complexity

Still at the beginning of the 20th century, the public sector accounted for no more than 10 per cent of the gross national product; at the end of the same century, the ratio had risen to between 50 and 60 per cent. Demands on the public sector have increased, and its activities permeate virtually all aspects of human life from the cradle to the grave. Further, as the need for coordination increases, demands on management capacity at the centre grow more than proportionally to the volume of activities.

Devolution has increased over time

The 17th century management structure carried the seeds of continued decentralisation. Starting from a chancery and a handful of *collegia*, central government eventually evolved into a small chancery plus some 300 agencies. But decentralisation has also a spatial dimension. The Nordic model of local autonomy gives substantial freedom of action to local and regional levels for the supply of basic services such as education,

¹³ Dahlgren (1960). We are indebted to Gunnar Wetterberg for pointing out this reference.

health care and care for children and elderly. Regional and local authorities – responsible for about 80 per cent of public services – operate under government mandate, but with substantial degrees of freedom. This gives rise to another management problem – how to supervise and control some 300 municipalities and regional county councils while simultaneously respecting local autonomy as understood in the constitution.

The public sector has ceased to expand in relation to the economy.

During most of the post-war period, government has defined its interests and priorities by increasing expenditures. Now there is broad consensus that the public sector should not grow relative to the economy. Expansion in one policy area comes at the cost of other areas, at least in relative terms. Because expenditure increases are automatic in many areas, the scope for reallocation becomes narrower, and policy-making has become more painful.

Elite consensus has weakened

After almost half a century of left-dominated governments, Sweden entered a period of party fragmentation and increased political and financial instability in the mid-seventies. A long-standing tradition of mutual understanding between political leadership and administration was suddenly questioned.

Sweden has become a member of the European Union

EU membership has led to new problems of governance. Quoting from a recent report¹⁴, the government does not have a clear picture of the EU work performed at the agency level, is generally lagging in the preparatory phases of the EU legislative process, and has not sufficiently coordinated its own efforts with those of the agencies.

In summary, whereas the basic administrative structure has remained basically intact, the world around it has undergone fundamental change. The list above is far from

¹⁴ *Fem år i EU* (Five years in the European Union), Statskontoret 2000.

comprehensive but sufficient to justify that basic questions be asked. The authors of this report believe that time is ripe for a new debate about the design of central government administration.

8.2 Diagnosis

Increasing complexity is not unique to the public sector. Large-scale private enterprise has developed sophisticated techniques of management during the 20th century to cope with similar problems. The program budgeting techniques of the post-war decades, and its successor, performance management, has been the public-sector response to urgently felt needs to master increasing complexity. Performance management was announced as the method of management of central government in the Supplementary Budget Bill of 1988. Substantial freedom of action was given to the agencies in implementing public policies. Agencies were basically given a sum of money and a set of more or less concrete goals for their respective areas of responsibility.

The reform was a success in that line-item budgeting was abandoned for comprehensive cost frames to agencies. But developing performance indicators has not been a high-priority task. A survey made a couple of years after the reform¹⁵ indicated that performance indicators covered only a limited fraction of total central government outlays. And whereas performance measurement systems subsequently have been developed and introduced in some areas, the information generated is not received by competent task managers in the government office, let alone used for strategic deliberation. The presence of conflicting goals and the need for trade-offs are rarely acknowledged. With few exceptions, neither the government office nor the agencies have analysed the difference between outputs and outcomes, that is, between immediate results and the ultimate impact of policies pursued. Most important, the whole idea that

¹⁵ ELMA – åtgärder för att stärka resultatstyrningen (*Measures to strengthen performance budgeting*). Ds 1995:6, Ministry of Finance.

ministries have a strategic responsibility for governing agencies has not gained acceptance.

It is clear that political decision-makers in Sweden have not fully grasped what is needed to make a decentralised regime work. The complexity of the task that the ministries are assumed to play is not fully acknowledged. Giving freedom of action to agencies is rational, as long as they are equipped with a set of clearly defined tasks, if appropriate information about performance is gathered and analysed and if corrective measures are taken when necessary. In a survey carried out for the OECD by Schick¹⁶, the judgement was that among the handful of countries that have tested new methods of management, only New Zealand had taken the governance problem seriously.

Political decision-makers, who have felt uneasy about the new system and their ability to control it, have resorted to age-old methods of exercising power:

- ? Leading officials have increasingly been appointed among candidates with a political background who understand the implicit rules of the game of government. This may be a way to exercise at least some degree of political authority.
- ? The government chancery manages sizeable budget appropriations without involving the agencies, indicating inability or lack of interest to follow the explicit rules of the game.
- ? The delegation of authority to local government follows the same pattern. In the early 90's, unconditional transfers from central to local government largely replaced earmarked grants. But in recent years, a relapse into earmarked grants has occurred, and new detailed legislation has been adopted by parliament.
- ? There are numerous examples of ministries making decisions that agencies are better equipped to handle. Our examples indicate that ministries sometimes prescribe activities when they should be setting priorities, and that public resources as a consequence are used inefficiently.

In summary, the means-ends rationality that is a precondition for a well-functioning system of governance does not seem to permeate thinking deeply enough for decision-makers to feel comfortable with the procedures of the system. The common denominator of the symptoms observed is that political decision-makers, facing an administrative system that they do not master and that they feel poor solidarity with, relapse into archaic patterns of behaviour. Power is exercised by discretionary decisions rather than by rules, by appointing persons rather than by specifying competencies in open recruitment – in short, by specifying means rather than ends.

It should be stressed that there is no widespread, open discontent with the present structure expressed among political decision-makers. Rather, we interpret symptoms such as the above-mentioned as indicators of serious problems; those involved may not be clear about the origin of their problems, nor indeed of that there is a real problem in the first place. And while agency directors may be dissatisfied with the lack of response that they get from the government office, they may on the whole not be too unhappy with the extensive discretionary powers that status quo in reality provides them with.

The central deficiencies that we have identified – one general, two more specific – are the following:

- ? Governing agencies is not seen as a political priority. The actions of the Government Chancery are therefore not based on a thorough analysis of the governance problem at hand. In particular it fails to acknowledge the risk that ministries and agencies may have divergent interests, and that differences in information make agencies much stronger than is often assumed.
- ? The system is not transparent in its division of responsibilities between the main actors, which makes it difficult to enforce *ex post* accountability.
- ? The strategic capacity of the government office is inadequate for the task.

¹⁶ Schick, A., *Budgeting for results* (OECD 1995).

8.3 Learning from other countries

While Sweden's problems are by no means unique, its position as an outlier gives them a somewhat unusual character. Recent experience from other countries is a natural starting point for a discussion.

Governing by contracts or by agency?

The two reforms examined in depth in chapter 6 – the UK Next Steps Agency reform and the contractarian approach of New Zealand – differ substantially. The NZ reform is appealing in its quest for transparency, clear separation of responsibilities, and stress on accountability. The idea is that the roles of principals and agents in the various stages linking voters to final service producers should be well defined, once contracts have been developed and signed between the parties. But the fundamental problem of contract design – that *all contracts are incomplete* – cannot be eliminated. It is not possible to formalise all aspects of a relationship merely by designing a chain of such contracts.

In fact, it can be argued that formalisation sometimes is counter-productive. If, as we believe, the stability of ongoing relationships is central to the functioning of administrative structures, the tacit understanding of such relationships – what we have termed relational contracting – cannot be assumed away without serious negative consequences. Formalising a relationship threatens any otherwise tacit understanding by focusing the agent's attention to what is actually written down – “what gets measured gets done”.

What is the second-best solution in the imperfect world of incomplete contracts is open to discussion. One performance indicator would probably be too few, whereas ten are too many – that is probably as close as one can get to a general truth in this area. Moreover, when different targets are in obvious conflict with each other, it is the

ministry that is responsible for guiding the agency in how the trade-off should be dealt with, not the other way round.

For these reasons, and also because the NZ approach also in other respects is more distant from Swedish administrative tradition, the British experience seems more relevant to the current discussion. The first British reform attempt under the Thatcher/Major governments was incomplete in much the same way as Sweden's endeavours. The renewed attempt under the Blair government appears to be more fortunate – one that combines a rationalistic approach with due political authority. By placing accountability at the level of departments, it generates a true interest among political decision-makers for acquiring authority over the system of management – precisely what is needed to make it work.

Referring again to the administrative model developed in Sweden during the first half of the 17th century, it is clear from the memorandum quoted that the purpose of the model was to maintain full political control at the centre – the Chancery. The far-reaching delegation or diffusion of power that gradually developed was not intended. A Swedish model of governance that was true to its origin would be closer to Blair's UK than to current Swedish practices.

A big problem, if one accepts the above analysis, is that Sweden simply cannot repeat what has been accomplished under the Blair administration given its current administration. The centre is simply too weak. The great wave of agencification has left UK with about 25 per cent of its central government staff in the ministries and 75 per cent in the agencies. One agency (the Civil Service College) has even been “re-ministerialised”. The corresponding figures for Sweden are around 2 and 98 per cent, respectively (not counting the Foreign Office overseas administration among the ministries). Although a solution in one country cannot directly be used as a blueprint for another, it is quite clear that the level of authority exercised by the British ministries

when communicating with their respective agencies is unattainable in Sweden under the prevailing regime.

8.4 The way ahead for Sweden: Strengthening policy in administration

We do not believe that there are any constitutional obstacles to improvements in central government administration; nothing suggested below calls for any revision of the fundamentals of the Swedish administrative system. The separation between ministries and agencies, collective responsibility for cabinet decisions, and public access to documents exchanged between authorities are all important components of the Swedish administrative tradition that should not be sacrificed for the sake of administrative efficiency. The ban on ministerial rule concerns the exercise of power towards individuals or legal personalities, but this covers only a fraction of the decisions that together define policy-making. By consequence, nothing in what is proposed below infringes on the doctrine against ministerial rule. The policy proposals put forward below therefore consist in a re-tuning of parameters rather than in structural change.

What is proposed is that political decision-makers in Sweden accept the fundamentals of a rationalistic means-ends approach to policy making and implementation, taking command of it rather than shunning it as some of the current practice and malpractice indicates. What is needed is, generally speaking, that adequate resources be put at the disposal of political decision-makers in order to make it possible for them to master the system of government. Second, incentives have to be put in place to spur political decision-makers to pay attention to agencies. Far from representing a technocratisation of the policy-making process, this would amount to a democratisation. The current regime, if anything, suffers from too little politics at the appropriate places, not too much. Again, we stress that nothing in the constitution represents an obstacle to the kind of re-orientation that we propose.

Defining accountability clearly

The first requirement for any successful solution of the problem of governance is that accountability be clearly defined. Although the administrative borderline between the Government Office and the agencies is fairly clear, supported for instance by rules on public access to information, the demarcation line of political accountability is less so. In principle, the Cabinet is collectively responsible for government decisions and policy, but the lack of appropriate resources at the Government Office implies that agencies in important respects are *de facto* responsible to a varying degree. By consequence, ministers are often held accountable for decisions or acts that, strictly speaking, are beyond their domain of direct influence. In other cases, agencies are sometimes forced to assume responsibility for genuinely political decisions. This nebulosity makes it difficult for the citizen-voter to know whom to address when public services are not deemed satisfactory.

These problems are in some respects even more pronounced in the relationship between central and local government. Local autonomy as established in the constitution sets certain limits to the authority of agencies entrusted with the responsibility of surveillance.

Proposal 1. The division of labour between the chancery and the agencies must be clarified. Political accountability rests with the cabinet and cannot be delegated. Agencies are responsible for operations.

Assuming strategic responsibility in the Government Office

Strengthening accountability is no simple matter. For the agent to be able to accomplish his task, it is necessary that the principal states his objectives in clear terms. Simply expressed, the government has to specify what it wants. And this in turn requires that the ends-means problem described above be solved in a satisfactory manner. The quest

for accountability – a cornerstone in the democratic edifice – is thus one of the main arguments for a more active role for the GO in the governance process.

Political goals have to be translated into measurable indicators of success. The progress in this area has been uneven. Some activities lend themselves more easily to analytical treatment of this kind than others, and the system has been marred by large lacunas at least until recently. Further, the choice of performance indicators requires a judicious discussion of the number of indicators to be used in the evaluation of agency activities. Five or six often represents a reasonable trade-off between comprehensiveness and manageability; given this restriction, the choice must be made with extreme care.

Whatever difficulties there may be, they have traditionally been left to the agencies to handle. This is clearly not acceptable. In order for a ministry to be in full command of the process, the analytical work necessary to qualify for the exchange with its subordinate agencies cannot be delegated to the agent; it must be performed by the principal.

A second deficiency that has limited political interest in strategic governance is that indicators are not always adapted to the needs of political decision-makers. The availability of data and the proximity to the responsible agency have all too often governed the choice of performance indicators. Evaluation tends to become too narrow, and of limited use in the political discussion that it is intended to serve. A third problem has to do with the diversity of state activities. Sectors differ in many respects and both the way tasks and targets are defined and the choice of indicators has to be adapted to the specificities of each sector.

There are also instances of targets given to a certain sector that are in conflict with each other. These conflicts must be openly acknowledged from the ministerial side.

Both the comprehensiveness and the diversity problems and the problem of adapting the tools to the needs of political decision-makers have been addressed in the recent VESTA project¹⁷. The proposals emanating from the project, that will guide the development of economic management in the state for the next few years, aim at a more comprehensive application of performance indicators and improved adaptation of indicators to the needs of political decision-makers. Accrual accounting will be introduced, which improves the connection between the state budget and the budgets of the agencies, the latter being based on business-like accounting methods already.

The proposals are thus well taken, and may improve the overall level of central government economic management. But absent the broader approach to the problems of administration advocated in the present report, the changes suggested will most likely have a limited effect on performance in the deeper sense advocated here.

The instruments currently used for communication between the Government Office and the agencies – the regulatory letters (‘regleringsbrev’) and the ‘dialogue’ – have a role to play. But the present lack of balance in resources between the two parties involved and the low political priority of agency management reduces their value as instruments of governance.

Proposal 2: The Government Office must assume control of the process whereby political strategy is transformed into operative targets for the agencies and performance indicators are developed, with due respect to the specific circumstances in each particular sector.

Lack of political interest in agency management

¹⁷ Ekonomisk styrning för effektivitet och transparens (Economic management for efficiency and transparency), Ds 2000:63, Ministry of Finance (2000).

A recurrent problem is that political decision-makers do not mobilise enough interest in agency management. This is the ultimate reason why junior officials tend to be assigned to agency-related matters, and why neither sufficient time nor political resources are devoted to these matters.

If the precious proposal is followed, and day-to-day decision-making is guided by clearly formulated political ambitions and operative goals, there is greater hope that agency-related issues will attract more political attention. This would be the case in particular if the government makes it a habit to report annually to the parliament on progress made. Sweden has in recent years gained positive experience from such explicit declarations of intention in certain prioritised policy areas – cutting unemployment by one half, realising the medium-term goals of financial policy, and, for the next few years, to reduce the number of dependants on social allowance by one half. By using explicit goals and reporting annually to parliament, the government has been able to mobilise and focus the administration in a way that has been crucial to the success of the effort.

What is required is that this form of explicit linking between political mobilisation and administrative competence is applied to more areas, in order to make it the rule rather than the exception.

Proposal 3: Translate the political ambitions of the government into measurable goals for all policy areas. Report annually to parliament on the progress made in relation to these goals.

Lack of strategic capacity at the Government Office

Some agencies take their job seriously and produce vast amounts of information on output, performance, or even productivity. Even so, the Government Office is unable to process the information and integrate it into the political process. If delegation of authority is to work, feedback from the principal to the agent is fundamental to the

working of the system. But the absence of strategic capacity makes it highly unlikely that appropriate reactions be generated.

The inability of the Government Office to assume the role as strategic leader is illustrated in different ways. Governing the agencies is assigned to junior desk managers with limited experience, often on a part-time basis. The GO has many different tasks, and it is clear that the service function – support at short notice to ministers and state-secretaries – is given priority when scarce time resources are allotted.

The problem is not one of numbers only. Translating political goals into strategies, analysing scenarios implying different restrictions and contingencies and similar tasks require experience and formal education that is currently fairly rare among GO employees. As shown in chapter 4, a background in research is rare. Experienced officials frequently leave the GO for an agency, more often than the other way around.

In order to perform the tasks of a well-functioning strategic unit, we estimate that 3 or 4 persons are needed to act as a competent counterpart to the average agency. At least one of these should have research education. Given currently about 300 agencies, it would take about 1000 man-years, rather than the currently 100, to do the job. This figure is of course highly approximate, but it gives an idea of the order of magnitude involved.

The Swedish EU presidency of the spring of 2001 led to a number of recruitments. The competence necessary for this particular task cannot be expected to be the same as those required for strategic planning however, and therefore these recruitments do not eliminate the deficiencies identified.

In summary, the agencies do not have a competent partner in the Government Office as it is currently organised and staffed. We believe that the basic tasks of central government can be solved within the given overall size, and that consequently most of the changes should be based on a transfer of staff from the agencies to the GO.

Proposal 4: Increase the number of employees in the Government Office by approximately 1 000 persons. Raise their average formal competence and experience. Create strategic units for major policy areas in the Government Office. Reduce the number of employees at the agency level correspondingly.

Autonomous institutions of evaluation

The complicated task of separating the effects of public intervention from exogenous change that would have taken place in the absence of such intervention – separating *outputs* from *outcomes* – is in most cases not performed at all. This is normally a research task, requires technical skills in statistical analysis and hypothesis testing, and is not always in demand among decision-makers.

During the 1990's a handful of autonomous agencies were created in order to balance the dominant role of large agencies or other dominant actors in their respective sectors. This is of course not a uniquely Swedish idea; New Zealand has had notable success with its Education Review Office, which independently from the Ministry of Education reviews the performance, management and finances of all schools. The new Swedish agencies are:

- ? The Swedish Council on Technology Assessment in Health Care (SBU)
- ? The Swedish Institute for Food and Agricultural Economics (SLI)
- ? The Office of Labour Market Policy Evaluation (IFAU).

Chapter 5 described the Swedish Institute of Transport and Communication Analysis (SIKA) to have more of a coordinating than monitoring assignment; we still believe that in principle, it could belong to this group of agencies.

All of these have a relatively tight link to the academic research community that sustain autonomy and provides a natural quality assurance mechanism via peer review. They address the fundamental question of evaluation – what current policies have achieved compared to what would have happened in the absence of policy. This is substantially more difficult than developing performance indicators for given activities. It gives rise to sophisticated statistical problems and has attracted the interest of the most high-ranked academics. By performing this task, they not only break the information monopoly that large agencies tend to establish in their respective domains of responsibility but also raise the basic question what is at all achieved by public intervention. A range of policy areas could benefit from similar initiatives, for instance:

- ? social policy
- ? education
- ? aid and development policy
- ? environmental policy
- ? defence.

The Swedish parliament has also decided to create a new state audit institution under parliament, to be in operation in 2003. This institution will replace the previous bodies of the Parliamentary Auditors and the National Audit Office under the government. Naturally, the government will have to develop its own internal audit resources in order to retain control of the agencies, filling the lacuna after the National Audit Office. But the new audit institution will give parliament a much stronger instrument of control. The reform will consequently put new requirements on the capacity of the Government Office in the area of analysis and control.

Although these agencies of evaluation above all serve the public interest, they indirectly contribute to a re-balancing of the relationship between the Government Office and other agencies. Indirectly, they also raise the requirements on the analysis capacity of

the Government Office in order for the latter to be able judge critically the arguments and counter-arguments that naturally arise in the debate between the operative and the evaluating agencies.

Proposal 5: Create autonomous agencies of evaluation for important policy areas.

Appointment policies

On several occasions, we have touched upon the procedures of appointment to high posts in both agencies and ministries. There is evidence that these procedures increasingly are being politicised, and we have also provided a possible explanation for this phenomenon; choosing ‘appropriate’ chief executives may be one of the most important tools for agency steering in the absence of explicit instructions. According to the constitution, only relevant factors such as “merit and skill” should guide the choice among candidates in the administration at large. We do not believe that appointment of high officials should be an exception.

The model adopted in the academic world is an example of an open procedure based on criteria specified in advance, expert committees that publicise their judgement of the candidates, and possibilities for the candidates to appeal. If such a system is considered to be too autonomous, hybrids could be developed. According to the ancient “bishop model”, an expert committee selects three candidates and rank them, and the government then picks one of these, normally the highest-ranked. Even such a change would enhance credibility of the assignment procedures.

More open assignment policies would force the government to be more specific about what it expects from a director-general and her/his agency. By consequence, it would make it easier to hold the parties accountable for their respective tasks.

Proposal 6: Base the assignment of high officials on transparent procedures, involving explicit competence requirements and expert opinion.

Rewards and sanctions

As stressed repeatedly above, feedback is a vital part of a well-functioning ministry-agency relationship. Feedback can be positive or negative, depending on performance. A complicating factor in the public sector is that the repertoire of both rewards and sanctions is extremely limited. A successful director-general can be rewarded after normally six years by being given the responsibility for a larger or more important agency, and less successful colleagues can be punished by not being given renewed confidence. In extreme cases, a director-general may be deposed. But such actions are not frequent enough to be efficient, and are also difficult to tailor to some particular purpose.

Disclosure of information about agency performance may be a more sophisticated instrument for this purpose. Starting in the early 1990's, the government annually publishes a list of "Measures taken by the government as a result of observations made by the National Audit Agency" in the spring budget bill. This simple announcement may make agencies much more alert to the comments from the auditors. Similarly, the National Financial Management Authority publishes an annual rating of the economic management of the agencies.

The above two examples focus on inadequate performance. But also a general statement on the progress in various sectors – including reports on the achievements of the agencies – could be a complementary means of strengthening the feedback from decision-makers in parliament to the administration. In fact, the Budget Act in force since 1997 requires the government to inform the parliament about results achieved in various areas of operation, so the legal support for this institution is already in place.

Proposal 7: Develop the repertoire of rewards and sanctions to promote desired behaviour among agencies. Investigate in particular information as a means of generating pressure for change.

The separate proposals that we have put forward are not in themselves enough to bring about a change of regime. The government must for that purpose also declare its intention to take command of the decision-making process by strengthening the strategic capacity of the government office. This will affect all aspects of administrative policy – staffing, targets, performance measurement, appointment procedures etc. By a policy statement we have something different in mind than what was presented by the government in the year 2000 under the heading of “An administration at the service of democracy” (‘En förvaltning i medborgarnas tjänst’), representing a number of good intentions that nobody would argue against.

Problems not dealt with

We have not discussed the *number of agencies* in this report, although this parameter is certainly of some relevance to the problems addressed. There is a tendency to create a new agency every time a new problem emerges. The number of agencies is probably above the optimal value. Finding something closer to an optimum would require an investigation that goes beyond the scope of this report, however.

The relationship between central and local government is another matter barely touched upon, although some of the authority problems are definitely more pronounced in connection with the state-local dimension. A full discussion would carry into the constitutional area, which, again, is outside the scope of the report.

Further, we have not delved into the possible links between the way in which Swedish central government is organised and the requirements of EU membership.

8.5 The proposals in brief

Proposal 1. The division of labour between the chancery and the agencies must be clarified. Political accountability rests with the cabinet and cannot be delegated. Agencies are responsible for operations.

Proposal 2: The Government Office must assume control of the process whereby political strategy is transformed into operative targets for the agencies and performance indicators are developed, with due respect to the specific circumstances in each particular sector.

Proposal 3: Translate the political ambitions of the government into measurable goals for all policy areas. Report annually to parliament on the progress made in relation to these goals.

Proposal 4: Increase the number of employees in the Government Office by approximately 1 000 persons. Raise their average formal competence and experience. Create strategic units for major policy areas in the Government Office. Reduce the number of employees at the agency level correspondingly.

Proposal 5: Create autonomous agencies of evaluation for important policy areas.

Proposal 6: Base the assignment of high officials on transparent procedures, involving explicit competence requirements and expert opinion.

Proposal 7: Develop the repertoire of rewards and sanctions to promote desired behaviour among agencies. Investigate in particular information as a means of generating pressure for change.

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