Modernization of the Federal Civil Service: Methodology for Functional Reviews

Paper produced for the Russian Federation Government

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Modernization of the Federal Civil Service: Methodology for Functional Reviews

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This paper does not reflect the views of the World Bank or its Executive Directors.
I Introduction

Request for comparative analysis of international experience in the area of functional reviews

The paper was produced in response to a request to the World Bank from the Russian Federation Government. The Government requested that a comparative analysis be undertaken of approaches taken in recent years in a range of countries in the area of program, agency and functional reviews. For the sake of simplicity, we refer to all such reviews in aggregate as functional reviews.

Objectives of this paper

The paper sets out a methodology for conducting functional reviews in Russia which is both appropriate to present needs and circumstances in Russia; and which also takes appropriate account of lessons and experiences of conducting such approaches over recent years in a wide range of countries. The paper summarizes a number of the different approaches adopted by a number of countries to developing and implementing functional reviews; assesses the applicability of different approaches to different objectives and circumstances; and identifies what is felt to be the most potentially useful approach for conducting functional reviews in the Russian Federation as part of the approach to implementation of proposals for modernization of the Federal Civil Service over the short to medium-term. This approach is based on a model which we have described as intermediate functional reviews.

Recommended approach: Intermediate functional reviews

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

Objectives of intermediate functional reviews

Intermediate functional reviews may be developed and implemented to meet the following objectives:

(i) identifying expenditure reductions;

(ii) reducing the size and scope of Government through rationalizing Ministry structures; and through identifying functions and services which may be commercialized, spun off, decentralized to lower tiers of Government, or simply eliminated;

(iii) securing increased efficiency in Ministries’ performance;
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-(iv) securing increased effectiveness in Ministries’ performance through strengthening the focus of individual civil servants on the achievement of key Government goals and objectives (as set out in the Government’s work program); and strengthening the responsibility and accountability framework in which civil servants operate.

Implementation of a program of such functional reviews should therefore lead to increased focus on the achievement of priority Government goals and objectives; while allowing significant expenditure reductions in many areas to be made (it should be noted though that the outcome of such reviews in certain areas could be the identification of the need for expenditure increases); but without sacrificing efficiency and effectiveness in service delivery. The approach can be seen as consistent with the priorities for modernization of the state and for building a strong and effective Government machine as set out by President Putin in his annual address to the Federation Council of April 2001. Development and implementation of such a program of functional reviews could be one of the early priority measures employed when moving to the implementation phase of the proposals set out in the Concept for Modernization of the Federal Civil Service.

Links with public expenditure reviews

Such a program of functional reviews could also be used to build on the program of public expenditure reviews at present being undertaken as part of the inter-related but separate exercise to secure expenditure reductions and to increase efficiency and effectiveness in Government expenditures.

The ideal sequencing of the expenditure reviews and functional reviews would be as follows. A broad public expenditure review (PER) would be undertaken of a particular Ministry structure, including all the budget entities at present falling under that Ministry. The results of that broad PER would then be used to guide determination of an appropriate budget ceiling for that Ministry for the following year’s budget. A functional review exercise could then be undertaken on that Ministry and its organization structure and budget entities with two purposes in mind. Firstly, to provide assurance to central agencies of Government such as the Ministry of Finance, the Ministry of Economic Development and Trade and the Apparat of the Government that the determined budget ceiling for a Ministry can be achieved without jeopardizing achievement of key Government priorities and objectives in the areas falling in the remit of that Ministry. Secondly, the exercise could be used by the management of the Ministry in question to enable them to identify the most appropriate arrangements for prioritization and provision of functions and services in the context of both the Government’s overall objectives and goals, but also in the context of the determined budget ceiling.

Less ideal, but more pragmatically, there is an opportunity to build on the two types of review currently taking place at federal level. There is a series of narrow, sectoral Public Expenditure reviews initiated by the Ministry of Finance, focusing on programs and policies, regardless of the entities carrying them out. They are intended to influence and change budget allocations. There is also a series of reviews of individual spending ministries, coordinated from the Office of the Prime Minister. These involve the Budget Department and Treasury. The main aim of these is to take
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stock of the legal basis of budgetary institutions and spending units and to trace the flow of money through them.

Given the de facto diversity and autonomy of public bodies, functional reviews might be a pragmatic way forward. This would respond to the seeming realities of (a) an overhang of unfunded legal mandates - enabling agencies to choose functions from a larger menu of legally authorized activities and (b) the employment of many staff on a personal basis, owing their level of remuneration pay to the strength of their informal relationships within the agency.

Next step: Implementation of pilot functional reviews

The objectives set out above could be achieved through making provision in the Action Plan to be developed for the Modernization of the Federal Civil Service for the implementation of a number of pilot functional reviews initially over the period October 2001 to March 2002. Given this, the Government, supported by the World Bank, should move over the period September to October 2001 to mobilize and secure the required internal budget resources and any additional external donor financing required to cover the costs of undertaking such pilot exercises; and of a subsequent ongoing rolling program.

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

Countries and functional review experience examined

In the course of our work on this comparative analysis, we examined the following international examples of and experiences from program, agency and functional reviews:

Brazil – Inventory of Government programs

Canadian reviews:
Government of Canada – 1994 program review
Government of Canada – ongoing Alternative Service Delivery reviews
Canada : Province of Alberta – ongoing Alternative Service Delivery reviews
Canada : Province of Manitoba – ongoing Alternative Service Delivery reviews
Canada : Province of New Brunswick – Program and Service Review
Canada : Province of Ontario – ongoing Alternative Service Delivery reviews
Canada : Province of Quebec – Autonomous Service Unit Program
Canada : City of Winnipeg – Management Reference Model reviews

Jamaica – agency modernization diagnostic reviews

Jordan – functional review of the Department of Administrative Development

Kazakhstan – 1998 functional review

Latvia – 1999 functional review of the Ministry of Agriculture

Macedonia – 2001 wagebill reduction review

New Zealand – reviews of the State Sector

Nicaragua – structure and function diagnoses

Papua New Guinea – functional reviews

Tanzania reviews:
Tanzania : Review for agency status
Tanzania : Organization and efficiency reviews

Thailand – 2000 functional reviews

UK reviews:
UK : Prior Options reviews
UK : Better Quality Services and Best Value Reviews
UK : Market Testing
UK : Fundamental Expenditure reviews

USA – Bottom up review of the Department of Defense

A summary assessment of each of the above exercises is set out in Appendix 3. Our detailed assessment of each of the above approaches and exercises is set out in the companion World Bank paper: "Choosing Efficiency and Effectiveness Reviews". ¹

¹ There are considerable overlaps between these two papers.
Objectives of functional reviews

Internationally, functional reviews have focused on different concerns. Some have concentrated on policy effectiveness, with little interest in the organizational details of how governments structure themselves. Others have focused on the organizations, taking the policies as given and asking how organizations can be better structured for efficiency. Some have been comprehensive, others narrow. Finally, while some have started with clear ex ante targets, others have adopted a methodology but have not quantified any anticipated efficiency savings.

Reviews can focus on two different sorts of potential reform objects: organizational and policy. Organizationally, reviews can identify individual agencies or work units that are to be restructured for efficiency reasons or, at the other extreme, leave the question of which organizational actors are implicated completely open. In terms of policy, reviews can pinpoint particular activities or services as requiring closer examination, or can require that all government policies and programs be considered.

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

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

Typology of functional reviews

The spectrum of organizational and policy specificity can be seen in Figure 1. As the figure suggests, there are many combinations, but the basic picture is of five types of reviews, with increasingly narrow concerns:

1. 'Pure' policy or program reviews

   Description:
   These reviews envisage comprehensive policy reforms, implying that low priority programs can and will be stopped and that efforts will be targeted at higher priorities. The reviews are disinterested in organizational level arrangements, envisaging potential closures but not foreshadowing detailed restructuring or business process changes.
Typical applications:
Many efforts to define the government sector in transition economies fall within this category. Reviews in preparation for the divestiture of non-core activities and ceasing non-government functions, including the review of agencies/State owned enterprises (SoEs) for closure/privatization, fall within this category since organizational restructuring is incidental to the larger objective of elimination of non-priority programs.

Examples:
- Brazil – inventory of Government program
- Government of Canada – 1994 program review
- Kazakhstan – 1998 functional review

2. 'Pure' efficiency reviews

Description:
This type of review envisages no major changes in government policies and programs, assuming that organizational and business process changes can generate the same outputs at greater efficiency.

Typical applications:
The reviews can be purely budgetary, preparatory to hiring and wage freezes and base pay reductions, or to across the board staff cuts and early retirements. The reviews can also be in preparation for the development of annual efficiency targets for agencies.

Examples:
- Macedonia – 2001 wage bill reduction review

3. Upstream program and efficiency review

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

Typical applications:
Since only one example has been identified, it is a little misleading to refer to 'typical' applications. In New Zealand the reviews were strikingly top down, centralized, and expert-driven. Political ownership and conceptual rigor were the hallmarks. Buy-in from the wider public sector came later and there were relatively few attempts at broad participation during the process.

Examples:
- New Zealand – reviews of the State Sector

4. Intermediate functional and agency review

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

**Typical applications:**
The elimination of duplications, the consolidation of similar services and the merger of offices from different ministries or departments, are all within the purview of these reviews. The reviews tend to comprise a methodology set by the center, and are generally undertaken by multi-agency teams. There appears to be considerably more experience to date in running and managing this type of review.

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

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

**Description:**
These entail dropping or changing specific activities and services, or the detailed restructuring of a few specific agencies.

**Typical applications:**
The consolidation of similar services within the same ministry or department, automation and contracting out are generally part of the review.

**Examples:**
- Canadian reviews: Province of Quebec – Autonomous Service Unit program
- Jamaica – agency modernization diagnostic reviews
- Tanzania reviews: Review for agency status
- UK reviews: Prior Options reviews; Market Testing
Figure 1  Choices for the review focus

| Organizational level focus – efficiency concerns ("running costs", service quality) |
|-------------------------------------------------|-------------------------------------------------|-------------------------------------------------|-------------------------------------------------|
| No organizational efficiency improvements sought | Whole of government efficiency improvements sought | Department or agency | Sub-units |

| Policy and program level focus – effectiveness concerns |
|-------------------------------------------------|-------------------------------------------------|-------------------------------------------------|-------------------------------------------------|
| No effectiveness improvements sought |
| 'pure' efficiency savings sought |
| No effectiveness improvements sought comprehensively or in groups of programs |
| 'pure' policy or program reforms sought |
| Effectiveness improvements sought |
| upstream program and efficiency reviews |
| Individual programs, government-wide activities |
| intermediate functional and agency reviews |
| Specific activities and services |
| downstream activity and organizational reviews and BPR |

It is reasonably clear that choices of focus towards the top left of Figure 1 – whole of government efficiency improvements and comprehensive program reviews – tend to be top-down rather than driven by individual agencies seeking to improve their own performance. Downstream reviews are harder to read in these terms as they can, in principle, be the result of self-selection but it is difficult to determine what really constitutes voluntary candidacy, as opposed to when donor pressures or central agency arm-twisting has provided the impetus for the review.

**Should efficiency and effectiveness targets be set in advance?**

Reviews of policies and programs can set effectiveness targets (e.g., reduce government involvement in the manufacturing sector, improve the effectiveness of education policies). Similarly, reviews of organizations can specify efficiency targets that are to be achieved at the whole of government level (e.g., total budget savings of a certain amount or percentage across government or in a particular sector, reduced costs of procurement across government), or at agency level (staffing or other running cost reduction of a certain amount or percentage in a particular Department).
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However, there is no requirement to pre-specify targets. Some review approaches are little more than trawls for information, apparently resting on the assumption that a better climate of efficiency and effectiveness information will probably trigger action – and that it is either unnecessary or tactically unwise to set some targets in advance. Most exercises involve setting some very general targets – disciplining themselves to lead to some detectable improvements in efficiency or effectiveness, but not specifying exactly where they will be found.

Figure 2 Specificity of targets

<table>
<thead>
<tr>
<th>Information trawls</th>
<th>General targets</th>
<th>Quantitative targets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. 'Pure' policy or program reviews</td>
<td>Kazakhstan – 1998 functional review</td>
<td></td>
</tr>
<tr>
<td>2. 'Pure' efficiency reviews</td>
<td></td>
<td></td>
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<tr>
<td>3. Upstream program and efficiency reviews</td>
<td>New Zealand – reviews of the State Sector</td>
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<tr>
<td>5. Downstream organizational reviews and business process re-engineering</td>
<td>Canadian reviews: Province of Quebec – Autonomous Service Unit program; Jamaica – agency modernization diagnostic reviews; Tanzania reviews: Review for agency status; UK reviews: Prior Options reviews; Market Testing</td>
<td></td>
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</tbody>
</table>
Aligning functional reviews with the budget process

The defining characteristic of efficiency and effectiveness reviews is that they entail a discrete approach for developing recommendations for change, outside of the usual budget and planning cycle. However, clearly the results of the review must ultimately be incorporated within the budget. This raises three issues for reviews to address as they engage with the budget process:

1. Budget comprehensiveness, including agency level cost-recovery mechanisms;
2. Flexibility in agency mandates;
3. Co-ordination with the budget cycle.

Failure to address these points could leave central ministries in the position of suggesting reforms that they have neither the budgetary information fully to justify nor the leverage fully to implement. In addition, reviews could identify areas in which legislative change is required, but do not themselves point out the feasibility of achieving those changes. Finally, there is a significant risk of mis-timing, with the Ministry of Finance/Budget Office provided with recommendations at an inappropriate point in the budget cycle.

Budget comprehensiveness

Upstream and intermediate reviews are generally dealing with more than one administrative unit. In reviewing entire programs, or in focusing on ministries and their subordinate bodies, their intention is to look at all the bodies that contribute to a program and to propose a reallocation of resources between and within them. They assume that ministries have information on the activities of their subordinate bodies, and have authority in enforcing changes in structure and in priorities.

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

Flexibility in agency mandates

One contributory factor in the intermittent successes of efficiency and effectiveness reviews in OECD countries has been that the legal mandates of the agencies and programs have been flexible, or have been changed in step with the review process. The Government of Canada – 1994 program review and the Better Quality Services and Best Value Reviews in the UK in the UK have required comparatively few legal
changes as it is largely within the authority of the relevant ministers to amend the structure of the executive bodies and to simply cease provision of some services.\(^2\)

In other European and Latin American administrative traditions, the situation is very different. In those contexts, efficiency and effectiveness reviews must therefore consider the possibility that significant program changes will require legislation, with all the accompanying uncertainties thereby entailed.

**Coordination with the budget cycle**

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

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

**Formal evaluation undertaken of international functional review experience**

Of all the international reviews examined, few have been the subject of any systematic evaluation.

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

It is important to note that other program reviews have not had such positive outcomes. An earlier review in Canada, led by the Nielsen Task Force in the mid-

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\(^2\) The reforms to the intergovernmental fiscal transfers were of course an exception to this and required significant legislative change (Tupper 1996).
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1980s, led to a large number of volumes on the evaluation of departmental programs and policies, and detailed recommendations for change. However, little demonstrable action was taken on this reform effort for several reasons. It was perhaps over-ambitious and overly concerned with efficiency savings rather than a clearly understood revision of the role of government. This may have led to some confusion between the policy and the institutional changes that it was recommending. Also, it was driven at the political level by a new government, with a strong suspicion that there was a hidden political agenda, reducing buy-in and commitment to change. Additionally, in that period of deficit financing in the 1980s, budget constraints were not felt to be particularly hard. The 1983 Grace Commission in the USA also had questionable impact.

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

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

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

The intermediate functional and agency reviews undertaken in the Latvia—1999 functional review of the Ministry of Agriculture and the US “Bottom up” review of the Department of Defense were both reviewed in varying depths. The Latvia review was followed by an assessment by an independent consultant that found that the

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recommendations of the review had been well implemented, although there had not been sufficient time to evaluate the impact (István 2000). The General Accounting Office comprehensively evaluated the US review (General Accounting Office 1995). It found that the Department of Defense incorporated unsubstantiated assumptions about the availability of forces, supporting capabilities, and enhancements that it concluded were necessary.

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

No comprehensive evaluations of the 'pure' efficiency reviews or of downstream organizational reviews and business process re-engineering listed in Appendix 3 were identified. Initial results from Macedonia on the impact of the review there suggest that progress towards substantial efficiency savings has been limited.

There is remarkably little data available on the costs of reviews. The evaluation of the UK Best Value pilot reviews noted that only half of the responsible managers felt that the subsequent savings would recoup the costs of the reviews (Department of Environment 2001). However, it is not clear whether this is an accurate prediction of the actual costs and benefits.

What determines the type of review?

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

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

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

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

The New Zealand upstream program and efficiency review reflects the presence of a remarkably strong central agency (Treasury) with excellent connections within a relatively small business and professional community and with a remarkably coherent set of political and ideological positions (Lowe and Roper 1996).

There seems to be varying forces driving the intermediate functional and agency reviews. Some of those with general targets are seemingly triggered by the supply-side phenomenon of a body of expertise within the public sector amounting to a continuing faculty of 'reviewers' looking for business. However, the US example seemingly reflects, at least in part, a defensive maneuver on the part of the department concerned, wanting to head off anticipated funding difficulties. All of these types of review are undoubtedly stimulated by the widespread perception that new management technologies and approaches can enable improvements in operational efficiency. The Canadian 'alternative service delivery' reviews have the strongest ideological connotations, with a sense that there is a new set of ideas whose time has come.4

A different supply-side issue – the presence of external donors offering extensive Technical Assistance – seemingly in some cases may trigger intermediate functional and agency reviews with specific quantitative targets.

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

4 It is important to keep in mind that recent research on comparative reforms discredits any notion that there is a single, first-best model towards which OECD public sector management arrangements are relentlessly tending. See for example (Pollitt and Bouckaert 2000).
Summary of the different approaches to program and functional reviews

Figure 3 provides a summary of the types of reviews identified in this paper.

**Figure 3  Distinctive features of efficiency and effectiveness reviews**

<table>
<thead>
<tr>
<th>Reviewing what?</th>
<th>'Pure' policy or program reviews</th>
<th>'Pure' efficiency reviews</th>
<th>Upstream program and efficiency review</th>
<th>Intermediate functional and agency review</th>
<th>Downstream organizational reviews and business process re-engineering</th>
</tr>
</thead>
<tbody>
<tr>
<td>Budget comprehensiveness</td>
<td>Critical</td>
<td>Important</td>
<td>Less important</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Coordination with the budget cycle</td>
<td>Changes in the budget envelopes available to the spending ministers announced at the start of the budget cycle</td>
<td>Selected ministries must offer up their proposed rationalization plans following the distribution of the budget guidelines</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Drivers of the reviews</td>
<td>De-legitimization of the usual policy process</td>
<td>Donor encouragement</td>
<td>Strong central agency and coherent set of political and ideological positions</td>
<td>Desire on the part of central Government agencies to secure increased efficiency and effectiveness and value for money</td>
<td>Not clear</td>
</tr>
</tbody>
</table>
Modernization of the Federal Civil Service: Methodology for functional reviews

Selection of most appropriate methodology for Russian Federation: Intermediate functional and agency reviews

Given the priorities of the Russian Federation Government in the areas of civil service reform and of securing expenditure reductions and increased effectiveness in budget management and execution, the most appropriate model for the Russian Federation Government to consider adopting at present is that of the intermediate functional and agency review. This was confirmed in the detailed discussions with our Russian counterparts. Such a program of reviews would be designed to be undertaken at the level of an individual Ministry, including all its associated organizational units and budget entities. Such reviews would also be undertaken in the context of explicit top-down criteria established by the Ministry of Finance together with the Ministry of Economic Development and Trade, and the Apparat of the Government. As outlined in the discussion of this type of review above, these reviews would be designed to allow for significant restructuring of present Ministerial structures, with some functions/entities identified for being spun off or commercialization, some for decentralization to other tiers of Government, and some potentially simply for closure or elimination.

This program of functional reviews would be linked explicitly to the current program of broad PERs being pursued by the Ministry of Finance as follows. The ideal sequence would be that a broad PER is completed for a Ministry and all its associated structures (at Federal Budget level); the budget ceiling/envelope for that Ministry for the following year would then be determined given the findings of the PER; and the functional review of that Ministry’s structure and functions would then be undertaken to enable the Ministry most appropriately to respond to the conflicting challenges of being able to deliver on its priority commitments under the Government’s work program, while respecting the budget ceiling set for the Ministry, and achieving also optimal levels of efficiency and effectiveness.

Implementation of such a program of functional reviews could perhaps most appropriately be achieved through including in the Action Plan for securing implementation of the Concept for Modernization of the Federal Civil Service provision for pilot functional reviews to be launched in Ministries which have already gone through the PER process. Such initial pilot functional reviews would be completed over a six month period from October 2001 to March 2002; and the lessons learned from undertaking these pilots then built into design of the next set of reviews, which could be undertaken over the period January to June 2002; with a rolling program of reviews developed and implemented thereafter.

It may be appropriate here to offer two further comments. Firstly, while the approach set out above represents the ideal, it is probably more important quickly to build up experience of conducting such functional reviews and to seek to move quickly to implementation of their recommendations than it is to follow this ideal sequencing. Thus if a particular Ministry wished on its own initiative to have such a functional review undertaken on its structure, even if it had not at that stage already passed through a PER, then it would probably be appropriate to move ahead with such an exercise.
Secondly, while the remit of our work was restricted to Federal Government structures financed from the Federal budget, it could also be worth seeking to stimulate acceptance of this **functional review approach at the level of individual regional administrations and cities**, and to seek to encourage the completion of a number of such reviews at these levels. This is of course particularly important given that most of the service delivery responsibilities in key national expenditure areas such as education, health and social, are undertaken at the lower tiers of Government. It would be particularly valuable to seek to integrate criteria and findings from for example a functional review on the Ministry of Education at Federal level, together with functional reviews of education service delivery in a number of regions and cities.
III Proposed Approach to Functional Reviews in the Russian Federation

Key elements of the recommended functional review approach

Typically, these reviews start with the identification of Ministries to be subjected to such a review by the key central agency (or agencies) with responsibility for the review(s). In the case of the Russian Federation, it is expected that the key central agencies which would play this role would be the Ministry of Finance together with the Ministry of Economic Development and Trade and the Apparat of the Government. While there is no clear pattern in how candidate Ministries are identified, a common approach is perhaps to offer some encouragement for volunteer Ministries to step forward combined with a top-down imposed rolling program managed by the center.

In many cases, and often with donor support, external (international and local) consultants are used. In other settings, multi-agency teams of civil servants are brought together specifically for the purpose of the review, provided with necessary frameworks and orientation by the responsible central agency, and then dissolved once the review has been satisfactorily completed.

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

1. Establish a task force for the functional review exercise and agree timing, criteria and precise methodology. Obtain agreement to the methodology from the ministry, from the responsible central agency (or agencies), and from all consultants/multi-agency teams that are to work on the reviews.
2. Facilitate extensive discussion within the Ministry on the review methodology so as to seek to minimize internal opposition to the review process and to eventual implementation of the recommendations of the review.
3. What are the priorities? Confirm that all parties understand governmental priorities as expressed in the Government’s program and how these priorities are reflected in disaggregated form at the level of the Ministry itself.
4. How can the Ministry’s functions best be separated out? The need is to disaggregate the functions that the Ministry undertakes using a classification such as the following:
   4.1 Policy functions;
   4.2 Co-ordination, supervision and performance monitoring functions;
   4.3 Service delivery functions;
   4.4 Support functions; and
   4.5 Regulatory functions.
5. Which functions should still be provided? The need is to review functions with a view to shedding services that can be stopped, reducing the volume or quality of services that cannot be stopped, and determining the resultant basic list of necessary functions:
   5.1 Those required for protecting public safety;
   5.2 Where there is a strong demand for the function to continue;
   5.3 Where the function supports other governmental priorities;
5.4 Where national or international law or the constitution require the function
5.5 Where the Government priorities cannot be achieved through regulation, taxation, transfers to subnational government, or subsidies.

6. **How can remaining functions best be provided?** The need is to determine the operating environment that is most appropriate for those necessary functions:
   6.1 Inherently governmental;
   6.2 Devolved or decentralized;
   6.3 Contracted from the private or not-for-profit sectors;
   6.4 Left to the private or not-for-profit sectors.

7. **How can remaining functions most appropriately be allocated to different types of Government bodies?** The need is to structure the 'inherently governmental' environment in more detail by recommending that functions are allocated to:
   7.1 a core ministry; or
   7.2 statutory commission or independent regulator; or
   7.3 supervised body or executing agency; or
   7.4 state-owned enterprise or trading body.

8. Provide guidance on the **internal structure of public sector organizations** – indicating:
   8.1 whether functions should be located in a common department
   8.2 whether departments/divisions need restructuring; and
   8.3 whether managerial responsibilities are balanced and sustainable.

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

It is suggested that the above approach be adopted as the basic methodology for undertaking the **first set of pilot functional reviews in the Russian Federation of Federal Government Ministry structures over the period October 2001 to March 2002**; and that appropriate provision to this effect be made in the Action Plan for securing the implementation of the Concept for Modernization of the Federal Civil Service.

In the following sections we comment further on some of the implementation issues and give more detail on some of the methodologies and approaches which could be developed and utilized during such an implementation schedule.
Identifying necessary functions

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

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

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

The first stage of the review work itself is generally to disaggregate the functions that departments and ministries perform and review them with a view to shedding services that can be stopped, reducing the volume or quality of services that cannot be stopped, and determining the basic list of necessary functions. Although clearly this task must be open and participatory, experience suggests that defining agencies’ current core tasks is at root the responsibility of the current management. Excessive reflection at this point can bog the review down in long discussions about the nature of the existing tasks.

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

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

Further details of this breakdown are provided in Appendix 1.
Functions that are necessary are:

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

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

In the event that functions are not considered to be still necessary, service shedding is the form of divestiture that occurs when government reduces the level of service or stops providing a service altogether. A private firm or non-profit organization may assume the service at no or nominal cost if there is a potential market. See (Government of Manitoba 2000).
Decision tree 1 Necessary functions

Review functions that departments and ministries perform

Disaggregate functions:
- Policy
- Co-ordination
- Service delivery
- Support
- Regulation

Is this function required to protect public safety?

Is there a strong demand for the function to continue?

Does this function support other governmental priorities?

Can the Government priorities be achieved through regulation, taxation, transfers to subnational government, or subsidies?

Does national or international law or the constitution require the function?

Can the scale be reduced?

Function still necessary

Shed service

Reduce quality or volume

Sources: Authors, derived from (Bannock Consulting 1999; Civil Service Reform Programme Steering Committee 1996a, b, c, d, e, f, g, h, i, j; István 2000; Wilkins 2001).
Determining how to undertake the remaining functions

The next question is the operating environments for undertaking those necessary functions. The choices are whether functions should be:

1. Regarded as inherently governmental and left at the central government level; or
2. Devolved or decentralized; or
3. Contracted from the private or not-for-profit sectors; or
4. Left to the private or not-for-profit sectors.

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

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

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

Figure 4 Operating environments

<table>
<thead>
<tr>
<th>Controlled by central government</th>
<th>Private sector ownership and risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public sector ownership and risk</td>
<td></td>
</tr>
<tr>
<td>1. Inherently governmental environment</td>
<td>2. Government controlled but private sector delivered</td>
</tr>
<tr>
<td>3. Devolved, decentralized environment</td>
<td>4. Private and not for profit environment</td>
</tr>
</tbody>
</table>

Independent from central government

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

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

1. **Complexity and political sensitivity** - some functions are too intricate and sensitive to be contracted out.

2. **Pragmatism** – although a market could be created to undertake the function, this has not happened.

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

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

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

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

2. **Others that relate to monetary transactions and entitlements**:
   a. Tax collection and revenue disbursements;
   b. Control of the Treasury accounts and money supply;
   c. Administration of public trusts.

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

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

Appendix 2 provides further details of when and how service provision can be undertaken through devolved or decentralized organizations, or through contracting from the private or not-for-profit sectors, and when responsibility for providing the service or not can be left to the private or not-for-profit sectors.
Decision tree 2 Selecting operating environments

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

Having allocated functions to operating environments, the next issue is how to structure the 'inherently governmental' environment. The choices are whether 'inherently governmental' functions should be located in:

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

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

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

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

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

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5 This draws from (Government of Manitoba 2000; World Bank 2001e).
6 Ministries are in a legal or constitutional sense indistinguishable from the state. They often have no specific legislative basis and their assets are the general property of the state. Their functions and objectives are multi-purpose, complex tasks, traditionally defined by legislation (Continental European traditions) or determined incrementally by Cabinet (UK and other Anglophone traditions). Their source of funding is almost entirely the state budget and they usually have nil or very minor revenue earnings. As they have no corporate or legal identity separate from the state, they have generally no legal competence to enter into corporate contractual relationships with suppliers.
7 Executing agencies reporting to Ministries (or reporting to Ministers but under the day-to-day supervision of a Ministry) are often indistinguishable from the state in the legal or constitutional sense. However, the relevant Minister generally defines their objectives (perhaps in a framework agreement) and their source of funding can include some revenue earnings. Executing agencies also rarely have legal competence to enter into contractual relationships with suppliers.
Policy areas prone to adjustment but not dramatic reversals – for example foreign affairs responsibilities are rarely located in an agency, while social security often is

Delivering services in which there is no market (non-contestable) but where the output required is relatively specifiable.

**Box 1 Canadian Special Operating Agencies**

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

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

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

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

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

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

**Box 2 Crown Corporations**

**Canadian Crown Corporations** are a special case of trading bodies. These are separate legal entities created by federal or provincial statute, generally with the intent of conducting revenue-producing, commercial activities for the public good. Crown corporation status represents the greatest degree of autonomy possible within the public sector. A Crown Corporation is normally a sizable agency that sets its own administrative policy, is financially self-sufficient, and has separate employer status. A board of directors, appointed in whole or part by government, is responsible for overall management and decision-making for the corporation. A Minister responsible answers in public and interprets the nature of the arm’s-length relationship, consistent with legislation and the public interest.
Decision tree 3 Locating inherently governmental functions

1. Is this policy domain volatile - with frequent significant political changes?
   - yes
   - no

2. Is the function particularly hard to specify?
   - yes
   - no

3. Is this function so politically sensitive that there is a need for some margin of safety?
   - yes
   - no

4. Is there potential for future privatization?
   - yes
   - no

5. Is this a regulatory function where arms-length checks and balances are necessary?
   - yes
   - no

6. Is this function specifiable?
   - yes
   - no

7. Is this policy domain prone to frequent technical adjustments?
   - yes
   - no

8. Is there scope for raising revenues from fees and charges?
   - yes
   - no

Decision made to regard as inherently governmental - and locate within central government

Sources: Authors, derived from (Bannock Consulting 1999; Civil Service Reform Programme Steering Committee 1996a, b, c, d, e, f, g, h, i, j; István 2000; Wilkins 2001).
Structuring the remaining organizations

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

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

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8 This draws extensively from (Bannock Consulting 1999).
Decision tree 4 Structuring public sector organizations

Decision made to locate function within public sector organization

Are there other functions of this type? yes

Can they be merged? yes

Can this be arranged to provide equal responsibility for senior staff? yes

Locate function in common department

Are divisions and departments of a viable size? no

Can divisions and departments be arranged to shorten reporting lines? no

Restructure and regroup departments and divisions

Are spans of control for managers appropriate? no

Restructure managerial responsibilities

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

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

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

The choice here is whether to impose uniformity or to set a broad framework allowing different emphases to emerge in different reviews.

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

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

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

The limited evidence on efficiency and effectiveness reviews suggests that they should respect three tactical rules:

1. Soften up the potential audience
2. Maintain the perceived legitimacy of the review
3. Bind the players to implement the results

Soften up the potential audience

Raising public concerns can generate support for reforms and develop some sense of urgency. The challenge is to build some "alternative political currencies"⁹, a sense that there are some political victories in taking tough action. In Canada and New Zealand, prior to the reviews and the subsequent reforms, the problems were clearly 'talked up' to generate a sense of crisis. There is little advantage in public debate on the technical design of reviews, but there is every reason to make the public aware of the dangers of doing nothing.

Data gathering and activity mapping can be a useful preparatory stage within the public sector. It is not necessarily linked to any concrete action, but preparing an inventory of what government is already doing for example, by tracking at ministry or department level the activities, staffing, budgets, organizations and functions, legal mandates (funded and unfunded) and the scope of operations, can generate a sense of momentum without creating resistance.

Mainstreaming the alternatives is also important to lessen subsequent fears. Noting some months in advance of recommendations that contracting out might be applied to new areas, or that different terms and conditions for some staff might be piloted, can lessen the eventual concerns.

Maintain the perceived legitimacy of the review

Being explicit about the areas where the review could propose changes to the scope and role of government makes the review more acceptable. Whether whole of government efficiencies are sought, or if the review is focusing on improvements to the efficiency and service quality in small organizational units, be clear to heads of departments what areas are under consideration.

Technical competence can be demonstrated by balancing the use of external consultants with teams drawn from several similar agencies within government. The arguments for the use of at least some external consultants were set out in the 1986 Nielsen Review in Canada. It noted pointedly that generally speaking routine evaluations conducted by departmental officials are undertaken for the agency head and tend to be self-serving. They considered that when review results are subject to disclosure under Access to Information legislation, they become even less frank. The consequence is that reviews tend not to question the fundamental rationale for continuing the programs, instead focusing on program impact and delivery. A further

⁹ Bill Dorotinsky suggested the concept of 'alternative political currencies'.
limit to departmental reviews is their inability to examine cross-agency programs or similar programs in other departments. See (Libbey and Sears 1996).

Typically there are three forms of external participation: Advisory Committee, Steering Committee and Task Force (Libbey and Sears 1996). An Advisory Committee can meet at key points in the review process to provide advice to the project manager and team and to challenge their findings, conclusions and recommendations. As advisors, the external participants exercise virtually no direct control over the project, although they can have the potential to exercise moral persuasion. The Advisory Committee and its members have little or no accountability for the outcome of the review.

A Steering Committee also meets at key points during the review project, but it has more authority than an Advisory Committee. The details of that authority should be established in the mandate of the Steering Committee, but might include, for example, the authority to make the final determination as to which issues or questions are pursued by the review team.

A Task Force would typically be appointed by a Minister to take charge of a significant and high profile review. The members of the Task Force take full responsibility for the final report and the entire review process.

Reviewing all functions and policies, including those implemented by the central agencies, will lessen the inevitable fear that the central agencies are privileged or protected. Being seen to be consistent assists in deflecting fear of victimization.

Where there is scope for voluntary rather than mandatory participation in the review, this clearly will build more interest and ownership. The assumptions that are underpinning the review should be transparent and available for challenge.

**Bind the players to implement the results**

Peer review of findings is valuable in building professional acceptance of the recommendations. This can be supplemented with a broader consultative group that advises during the course of the review, drawn from ministry staff and sector interest groups.

Announcements in advance that **review findings will be public**, and early release of detailed issues papers and terms of reference prior to reviews of individual ministries, accompanied by broad discussion options for policy areas, can make it harder to block implementation of the recommendations.

It is important to avoid complexity, with straightforward summaries of review methodologies and a simple statement of how the review findings will subsequently be disseminated.

Implementation considerations will cover the financial implications (with full costing/pricing with savings and new revenues assumptions shown) and the timing
and transition arrangements. A complete action plan will list recommendations, identifying:

- linkages with the budget timetable;
- time needed to plug information gaps;
- technical assistance needs;
- training needs;
- legal issues and legislative reform burden of different options; and
- alternative models for staff involvement during change.
IV Risks in developing a program of functional and agency reviews

Dashed expectations

Under the best of circumstances, efficiency and effectiveness reviews undertaken outside of the usual budget and planning cycle have a modest track record of success. The complex environment in this are in Russia might pose particular difficulties in linking review recommendations with the ongoing budget and planning process. Whatever the level of the reviews, it is hard to avoid a general sense of disappointment. They rarely seem to have delivered quite what was hoped and, where they did, the political and institutional context was such that it seems probable that many other approaches would also have worked. This is hardly an unusual finding in relation to administrative reform, but the implication is that the usual warnings about the limitations of technical approaches should be heeded particularly carefully in this area.

Perhaps part of the reason for the general ineffectiveness of efficiency and effectiveness reviews is that they embody a fundamental contradiction. By definition they are outside of the usual budget and planning process, probably needed because those more regular processes are ineffective. However, it is those usual planning and budgeting processes that must carry the results forward – and the managerial energy that is devoted to the reviews will not be spent on fixing those processes.

Limited evaluation evidence

The review model proposed in this note is similar to that undertaken in the Latvia functional review of the Ministry of Agriculture, the 'Bottom Up' review of the US Department of Defense, and the UK Better Quality Services and Best Value Reviews. These reviews, undertaken in very different settings under very different conditions, have been subject to varying depths of evaluation. The Latvia review was followed by an assessment from an independent consultant who found that the recommendations of the review had been well implemented, although there had not been sufficient time to evaluate the impact (István 2000). The General Accounting Office comprehensively evaluated the US review (General Accounting Office 1995). It found that the Department of Defense incorporated unsubstantiated assumptions about the availability of forces, supporting capabilities, and enhancements that it concluded were necessary.

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

There is remarkably little data available on the costs of reviews. The evaluation of the UK Best Value pilot reviews noted that only half of the responsible managers felt that the subsequent savings would recoup the costs of the reviews (Department of
Environment 2001). However, it is not clear whether this is an accurate prediction of the actual costs and benefits.

Review overload

These proposed reviews join the sectoral Public Expenditure Reviews being undertaken with the assistance of several donors, and the Spending Ministries Review, currently being undertaken out of the Prime Minister's Office. There are a large number of agencies involved and it is very possible that some ministries and state committees will feel that they have been over-reviewed.

Misalignment with the budget process\textsuperscript{10}

The effective utilization of functional and agency reviews in the Russian context will require that three major problems be addressed:
1. incomplete budget coverage, including off-budget cost-recovery;
2. inflexible mandates;
3. co-ordination with the budget cycle.

Failure to address these points could leave federal ministries in the position of suggesting reforms that they have neither the budgetary information to fully justify nor the leverage to fully implement. In addition, reviews could identify areas in which legislative change is required, but do not themselves point out the feasibility of achieving those changes. Finally, there is a significant risk of mis-timing, with the Ministry of Finance/Budget Office provided with recommendations at an inappropriate point in the budget cycle.

Incomplete budget coverage

In Russia the principles of budget comprehensiveness are officially recognized in the "Law on budget principles" 1991, but are not yet fully applied in practice. Many revenues and expenditures remain off-budget. The Spending Ministries Review, currently being undertaken out of the Prime Minister's Office, might assist in ameliorating these difficulties but for the moment the fact remains that there are significant off-budget revenues and expenditures. This means that Federal Ministries may in some cases have little information on the activities of their subordinate bodies, and equally little practical authority in suggesting changes or in monitoring their implementation.

If they are off-budget, cost-recovery mechanisms can exacerbate this problem significantly. If not carefully managed, excessive reliance on user fees and charges can encourage agencies to develop commercial activities, at the expense of their primary task of providing public goods. They can be an unpredictable source of revenues, and can make it difficult to establish appropriation levels for each spending unit. To mitigate these risks, all revenues raised directly by agencies through user fees and related means should be incorporated into the budget, even if earmarked. Though all earnings should be treated as budget revenues, the incentive for

\textsuperscript{10} This section draws significantly from (World Bank 1996)
Modernization of the Federal Civil Service: Methodology for functional reviews

Administrative units to raise revenues may be preserved by assigning the revenues to the units that collected them, as an addition to their normal appropriation, either in their entirety or as a proportion of the amounts raised.

The fiscal pressures in Russia have encouraged many public agencies to finance their operations through off-budget user charges. This might further reduce the information available to Federal Ministries on the activity of subsidiary bodies and undermine any incentives that they can provide to persuade those subsidiary bodies to restructure.

Inflexible mandates

One contributory factor in the intermittent successes of efficiency and effectiveness reviews in OECD countries has been that the legal mandates of the agencies and programs have been flexible, or at least that legislation has kept step with the review process. Upstream program review in Canada, and the "Best Value" reviews in the UK, have required comparatively few legal changes as it is largely within the authority of the relevant Ministers to amend the structure of the executive bodies and to change the operational arrangements for service provision or even to simply cease provision of some services.11

In Russia, the situation is very different. An extremely large number of services are provided on a statutory basis, and the associated organizational structures are themselves legally defined. The rigidities that this creates can be seen in the unfunded mandates that have been created for many public bodies by the extensive Federal social legislation. Revised Article 83 of the Budget Code allows for the attachment of a list of suspended items of legislation, where funds cannot be found for their implementation. It also notes that the Budget Law effectively supersedes any other legislation that establishes budget liabilities. However, despite this development, failure to provide a service remains subject to possible legal challenge and there are many ambiguities and many areas in which there is a legal or a perceived public entitlement, which agencies are not funded to respond to, but that would require primary legislation to remove.

In the Russian context, efficiency and effectiveness reviews must therefore consider the possibility that significant program changes will require legislation, with all the uncertainties thereby entailed.

Coordination with the budget cycle

There is a distinction between "upstream" and "downstream" reviews.12 Upstream reviews envisage comprehensive policy reforms, shifting from low to high priority programs, and the restructuring of government-wide processes including large scale restructuring of the machinery of government. Intermediate and downstream reviews have a more modest ambition and envisage dropping or changing specific activities

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11 The reforms to the intergovernmental fiscal transfers in Canada were of course an exception to this and required significant legislative change (Tupper 1996).
12 See the companion paper "Choosing efficiency and effectiveness reviews" for a more comprehensive treatment of this distinction.
and services, or the detailed restructuring of a few specific agencies. *Upstream* program reviews would shape the entire budget process, with reductions in the budget envelopes available to the spending ministers announced at the *start* of the budget cycle. The *intermediate* functional and agency reviews proposed in this note have their impact *during* the budget cycle. For these reviews, the selected ministries must offer up their proposed rationalization plans following the distribution of the budget guidelines. It is perhaps unrealistic to expect that ministries in the Russian Federation would willingly submit a radically reduced budget submission based on the review. It is more probable that the Budget Department in the Ministry of Finance would take the lead in proposing a new budget estimate based on the completed review.

However, the problem is one of timing. If a realistic timetable for a comprehensive functional and agency review is six months, then this requires that they are started this much in advance of the final budget reconciliation undertaken by the Budget Department in the Ministry of Finance. Missing this window will leave the Ministry of Finance with a series of unenviable choices. The Ministry can either restructure the estimates based on little more than guesswork. Alternatively the Ministry can wait a further year before the data from the review can be utilized. Finally, they can of course seek a budget amendment, with all the political risks that negotiating this through the Duma implies.
V Conclusions

This paper proposes a **methodology for functional reviews** – intermediate functional reviews - for application at the level of Federal Ministries or other Federal bodies of Government in the Russian Federation. It has emphasized the reasons for caution in investing significant time and resources into such reviews, highlighting in particular the challenges of aligning the output of such functional reviews to the budget process.

On a technical level, the paper has offered **four decision trees** that represent the choices facing review teams. The decision trees offer some guidance concerning the identification of necessary functions, how to undertake the remaining functions, dealing with inherently governmental functions, and structuring the remaining organizations.

In considering the **roll-out** of a program or functional and agency reviews, the paper has noted that the key choice is whether to impose uniformity through a centrally-driven top-down process, or to set a broad framework allowing different emphases to emerge in different reviews. Different approaches have been used in different settings with no clear picture emerging, although it is reasonable to assume that a centrally driven model logically precedes a more open model in which central guidelines are set out, but the details of review implementation are left with the agencies themselves.

Finally, the paper has argued for **three tactical rules** to be followed:

1. Soften up the potential audience, ensuring that the public in particular is aware of the dangers of taking no action
2. Maintain the perceived legitimacy of the review through the judicious and balanced use of internal and external teams
3. Bind the players to implement the results through peer reviews and binding public announcements prior to the review.

The initial caution is important. The track record of efficiency and effectiveness reviews is modest, and care should be taken not to invest large amounts of time and energy into elaborate methodologies that are ultimately unlikely to contribute to lasting change. An important task for an initial program of efficiency and effectiveness reviews is to contribute towards building a climate in which later reviews have a greater chance of success. The key challenge for reformers at present in the Russian Federation is to seek to achieve effective use of functional reviews as one of the critically important early mechanisms for securing implementation of the reforms envisaged in the process of modernization of the Federal Civil Service.
## Glossary

<table>
<thead>
<tr>
<th>Term</th>
<th>Description</th>
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<tr>
<td>Alternative Service Delivery</td>
<td>Alternative Service Delivery (ASD) refers to the organizational and structural choices in improving the delivery of programs and services. It is originally a Canadian term used to encourage managers to think imaginatively concerning the best organizational option.</td>
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| Central agencies                          | Those organizations in the executive branch that co-ordinate the activities of, and provide guidance to the operating ministries and agencies. Practices vary widely from country to country, but central agencies are generally regarded as including:  
  - the Ministry of Finance;  
  - the Cabinet Office, or the ministry assisting the Prime Minister or the Council of Ministers in the development and co-ordination of policy;  
  - the ministry or agency responsible for developing and coordinating policies in relation to human resource management within the public sector; and  
  - the Ministry of Foreign Affairs, in certain areas of work such as policy on European integration. |
| Contracting Out                           | Government transfers supply or operation of a function to a contractor for a specified period of time without relinquishing program responsibility and accountability.                                                      |
| Crown Corporation                         | A separate legal entity created by federal or provincial statute in Canada, generally with the intent of conducting revenue producing, commercial activities for the public good.                                                 |
| Decision trees                            | A method for conveying succinctly the complex assumptions and criteria that drive reviews – the source of their critiques of existing policies and organizational structures.                                          |
| Devolution                                | A form of public partnership involving an intergovernmental service accord where responsibilities are transferred between levels of government (for example federal and provincial) in return for payment for services delivered. |
| Divestiture                               | A form of privatization involving the outright sale of government-owned assets or enterprises. After divestiture, government generally has no role in the financial support, management, regulation, or oversight of the divested activity. Government may sell its assets or controlling interest in a service to a private company but protect the public interest through regulation. |
| Downstream organizational review and business process re-engineering | Reviews that envisage dropping or changing specific activities and services, or the detailed restructuring of a few specific agencies.                                                                 |
| Efficiency and effectiveness reviews      | A discrete approach for developing recommendations for change, outside of the usual budget and planning cycle.                                                                                                  |
| Employee Take Over (ETO)                 | An agreement between government and an employee group to have services formerly performed within government provided by the employees as private owners/operators.                                                    |
| Executive Agency                          | A service operation within government granted more direct responsibility for results and increased management flexibility needed to reach new levels of performance in the UK. It is an example of a supervised body or executing agency. |
| Franchising                               | A form of contracting out whereby government confers the right or privilege to a private concern to conduct a business or sell a product or service in a specific geographic area according to prescribed terms and conditions. |

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13 Also see (General Accounting Office 1997; Government of Manitoba 2000).
| **Government Owned / Contractor Operated (GOCO)** | An organizational and commercial arrangement where a government-owned facility is operated by a third party, usually a for-profit contractor. |
| **Intermediate functional and agency review** | An efficiency and effectiveness review considering the reshaping of some programs, dropping of some activities, and restructuring some entire agencies but without large scale changes to the machinery of government. |
| **Licensing** | A variation of contracting out through which government grants a license to a private concern to sell a product or service that would not otherwise be allowed outside the public domain. |
| **Machinery of government.** | The structure of government and allocation of functions to Departments and Ministries. |
| **Private, Not-for-profit Agency** | A formal agency volunteer program or a private non-profit service organization in which volunteers provide all or part of a service, either independently or under government direction. |
| **Privatization** | Shifting functions, in whole or part, from government to the private sector when there is no continuing public policy reason to retain responsibility within government. |
| **Public Partnership** | An intergovernmental agreement in which two or more jurisdictions contract with each other to deliver public programs or services. |
| **Public/Private Partnership** | A cooperative or joint venture between two or more parties in the public and private sectors, built on the strength and expertise of each partner. |
| **Service Shedding** | A form of divestiture that occurs when government reduces the level of service or stops providing a service altogether due to lack of demand, insufficient resources, or the desire to reduce the size of government. |
| **Shared services** | A form of public partnership involving a joint service agreement where two or more levels of government (for example federal and provincial) act together to plan, finance, and deliver a public service. |
| **Special Operating Agency (SOA)** | A service operation within government granted more direct responsibility for results and increased management flexibility needed to reach new levels of performance in Canada. It is an example of a supervised body or executing agency. |
| **Statutory commissions and independent regulators** | Agencies are "statutory commissions" when they have a well-defined separate legislative existence. Their objectives are often enshrined in a charter, and their functions are defined by legislation in addition to any powers of direction held by the Minister. They may also be non-asset owning (legally distinct but unable to own assets) or asset owning. They can be budget dependent (subvented) or collect significant revenue earnings. They can also have legal competence to enter into contractual relationships. |
| **Supervised bodies or executing agencies** | Executing agencies reporting to Ministries (or reporting to Ministers but under the day-to-day supervision of a Ministry) are often indistinguishable from the state in the legal or constitutional sense. However, the relevant Minister generally defines their objectives (perhaps in a framework agreement) and their source of funding can include some revenue earnings. Executing agencies rarely have legal competence to enter into contractual relationships with suppliers. |
| **Upstream program and efficiency review** | An efficiency and effectiveness review that envisages comprehensive policy reforms, shifting from low to high priority programs, and the restructuring of government-wide processes including large scale restructuring of the machinery of government. |
| **Utility** | A system, works, plant, pipeline, equipment, or service operated by government in the public interest. |
Appendix 1 : Classification of functions

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

1. **Policy functions**: such as strategic planning, legal drafting, development of performance contracts, minimum standards, norms, policy analysis and evaluation, forecasting. These functions tend to be regarded as 'inherently governmental' and requiring specialist skills, and are usually provided by core ministries within central government.

2. **Co-ordination, supervision and performance monitoring functions**: such as coordinating relationships between different bodies, monitoring the performance of subsidiary bodies, facilitating and enabling subsidiary bodies to reach their performance targets. These functions also tend to be regarded as 'inherently governmental' and undertaken by core ministries.

3. **Service delivery functions**: such as the provision of products or services to internal (other public bodies) or external (farmers, foresters, fishermen) customers. Service delivery is often provided outside of central government through contracting arrangements or by subnational government. When undertaken by central government this is normally performed by supervised bodies or executing agencies.

4. **Support functions**: such as financial management, human resources management, information systems, infrastructure, staff training, efficiency review and management audit; and secretarial services. These are increasingly contracted out except when regarded as inherently governmental for security or other reasons.

5. **Regulatory functions**: such as licensing, certification, permissions, accreditation, inspection, compliance, and financial audit. These functions are also often regarded as 'inherently governmental' and provided by statutory commissions and other arms length bodies within central government. It is widely maintained that regulatory functions should be separated from those policy functions that determine the regulations, and service delivery functions that provide services to customers.

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

There is, however, another principle implicit in the literature on this subject: "pragmatism determines practice". Whether or not the public sector should deliver services directly, there is little point in specifying an organizational option that cannot be sustained in practice. The debate concerning privatization in Russia is significantly a discussion about whether the first and second waves of privatization were victories for ideology over pragmatism, or whether in fact any shortcomings simply reflected a lack of viable alternatives (Nellis 2000).
Appendix 2: Moving responsibility outside of central government

Devolving and decentralizing

When?

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

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

Change processes

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

Private and not for profit environments

When?

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

There are three key questions in considering moving functions to this environment:
   1. Is there a market for these functions or services – or could one be created?
   2. Can government tolerate the risk of closure?
   3. Will any contingent liability be created or exacerbated?
The existence of a market for the services, or the possibility of creating a market, is generally regarded as more probable when policies are reasonably stable, when there is a prospect of raising revenue from fees and charges. The latter applies when the services are specifiable and contestable. See for example (Girishankar 1998).

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

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

<table>
<thead>
<tr>
<th>Expliciit liabilities</th>
<th>Direct liabilities</th>
<th>Contingent liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explicit liabilities</strong></td>
<td>Predictable obligations that will arise in any event</td>
<td>Obligations triggered by a discrete but uncertain event</td>
</tr>
<tr>
<td>Specific government obligations defined by law or contract - the government is legally mandated to settle such an obligation when it becomes due</td>
<td>• Foreign and domestic sovereign debt &lt;br&gt; • Budget expenditures—both in the current year and those legally binding over the long term (civil servant salaries and pensions)</td>
<td>• Guarantees for borrowing and obligations of fiscal subnational governments and public or private entities (development banks) &lt;br&gt; • Umbrella guarantees for various loans (mortgage loans, student loans, agriculture loans, small business loans) &lt;br&gt; • Guarantees for trade and exchange rate risks &lt;br&gt; • Guarantees for private investments &lt;br&gt; • State insurance schemes (deposit insurance, private pension funds, crop insurance, flood insurance, war-risk insurance)</td>
</tr>
<tr>
<td>Implicit liabilities</td>
<td>Implicit liabilities</td>
<td>Implicit liabilities</td>
</tr>
<tr>
<td>A moral obligation or expected burden for the government, not in the legal sense, but based on public expectations and political pressures</td>
<td>• Future public pensions if not required by law &lt;br&gt; • Social security schemes if not required by law &lt;br&gt; • Future health care financing if not required by law &lt;br&gt; • Future recurrent cost of public investments</td>
<td>• Defaults of subnational governments and public or private entities on non-guaranteed debt and other obligations &lt;br&gt; • Liability clean-up in entities being privatized &lt;br&gt; • Bank failures (support beyond state insurance) &lt;br&gt; • Failures of non-guaranteed pension funds, or other social security funds &lt;br&gt; • Default of central bank on its obligations (foreign exchange contracts, currency defense) &lt;br&gt; • Collapses due to sudden capital outflows &lt;br&gt; • Environmental recovery, disaster relief, military financing</td>
</tr>
</tbody>
</table>

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

Source: (Polackova 1999b)

Change processes

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

There are two key areas of market design:
1. Ensuring appropriate regulation; and
2. Enforcing sound corporate governance.

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

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

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

**Government controlled but private sector delivered**

*When?*

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

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

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

Change processes

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

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

Public/Private Partnerships are cooperative or joint ventures between two or more parties in the public and private sectors, built on the strength and expertise of each partner, where public needs are agreed upon upfront and are met through the appropriate allocation of resources, risks, and rewards. The contractual arrangement negotiated involves the private sector in the development, financing, ownership, and operation of a public facility, infrastructure, or service. Financial and human resources are pooled and responsibilities divided so that the partners’ efforts complement each other. The partners typically share any income or losses in direct
proportion to their investment. Such ventures differ from conventional service contracting in that the private partner usually makes substantial cash, at-risk, equity investment and government gains access to new revenue or service delivery capacity without having to pay the partner. Leasing and buy-out options can be used to facilitate public and private participation. Ultimately, an elected official or body is accountable to the public for decisions and results, while responsibility for achieving planned objectives is shared by the government and partners. (Thomas 1998) provides further details.

Box 3  Government Owned/Contractor Operated

Government Owned/Contractor Operated (GOCO) arrangements are a special case of such public/private partnerships. These are organizational and commercial arrangements where a government-owned facility is operated by a third party, usually a for-profit contractor. It is used when a government purpose-built facility managed by the private sector remains consistent with the public interest; when a government-owned facility has surplus capacity that a commercial operator can market to the private sector; when technology needs to be transferred to the private sector using private expertise; and as a transitional vehicle for a prospective operator who initially cannot afford to purchase the facility. Government’s expectation is that access to private management expertise will increase efficiency, business volumes, and leasing or royalty revenues while lowering unit costs. The contractual relationship negotiated provides for adequate control and intervention mechanisms to protect government interests; structures exchanges of information, requests for service, performance criteria, and evaluations to reflect full costs, profit, and accountability; and transfers and manages assets consistent with government’s long-term interests.
Appendix 3: Country Examples

Brazil – inventory of government programs

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

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

Canadian reviews:

Government of Canada – 1994 program review

Details of this review are provided on page 14. Program Review presented a new government early in its mandate with an opportunity to start fresh. The process was orchestrated centrally to review all government programs, including those implemented by central agencies, according to six criteria: public interest, role of government, jurisdictional alignment, external partnership, business principles, and affordability. Public expectations were managed by making the public aware of the dangers of doing nothing, informing the public of the advantages, and avoiding public debate on technical design. Public servants were kept involved and motivated by creating a sense of urgency, avoiding complexity, and promoting visibility. Bargaining with sub-national governments and other sectors featured concessions to ease offloading and contracting of federal responsibilities. Savings of $3.9 billion on a 1995/96 budget of $52 billion, rising to savings of $7.2 billion in 1996/97, were realized.

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14 See (Wilkins 2001)
15 See (Armit and Bourgault 1996; Aucoin and Savoie 1998)
As one concrete product from an otherwise somewhat discredited earlier reform program (*Public Service 2000*), Special Operating Agencies (SOAs) were conceived in 1990 as a method for the federal government to improve service and reduce costs in selected programs. SOAs allowed the semi-corporatization of some Departmental activities into business units with greater managerial flexibility but within the public sector.

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

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

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

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

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

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

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16 See (Treasury Board of Canada Secretariat 2001; Wilkins 2001)
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- Conversion of civil air navigation to a not-for-profit corporation;
- Negotiation of six employee takeovers with the National Capital Region Commission; and
- Privatization of government printing and publications.

Province of Alberta – ongoing Alternative Service Delivery reviews

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

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

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

Province of Manitoba – ongoing Alternative Service Delivery reviews

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

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

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

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

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17 See (Wilkins 2001)
18 See (Wilkins 2001)
$26 million (33%) new revenue and $20 million (17%) annual cost-savings, resulting in retirement of $11 million in provincial debt and sharing of $34 million in surpluses with the Province.

208 new private sector jobs and $100 million in new economic development activity leveraged in the provincial economy.

44% more service selection and 46% more service volume, 90% of which was provided on time to 120% more clients, with 93% client satisfaction and 100% client retention.

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

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

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

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

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

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

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

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19 See (Wilkins 2001)
20 See (Wilkins 2001)
• use alternative approaches to deliver redesigned programs more efficiently and effectively.

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

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

**Province of Quebec – Autonomous Service Unit program**

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

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

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

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

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

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

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21 See (Wilkins 2001)
22 See (Wilkins 2001)
activities, resources, and internal services that support public services, maps organizational roles, responsibilities, authorities, and accountabilities, and links public services to program outcomes.

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

**Jamaica – agency modernization diagnostic reviews**

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

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

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

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

A functional review was undertaken in 1999 following the merger of some central agencies to create the new Department. Details to follow.
Kazakhstan – 1998 functional review

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

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

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

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

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

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

See (Wilkins 2001)
than full cost recovery. The extent to which the government budget is obliged to cover their liabilities is not clear. State control can be illusory when the mechanisms for enforcing contracts, within and outside government, are weak.

The World Bank is working with Kazakhstan to make Functional Review an ongoing exercise at the central level and to extend the methodology and capacity to the regional and local levels.

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

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

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

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

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

A follow up evaluation (István 2000) confirmed that the process of reorganization closely followed that proposed by the review and that resistance to implementation among staff was relatively low due to a good understanding by staff of the

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24 See (1999)
methodology of the plan's preparation. The final structure of the Ministry was influenced rather than determined by the review, and senior managers accepted the methodology and have become "owners" of most of the findings and recommendations.

**Macedonia – 2001 wage bill reduction review**

Details are provided on page 18.

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

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

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

- State trading bodies were transferred from the core public sector into commercially driven public corporations. SOEs have substantial managerial autonomy under performance agreements with ministers. The purchase, supply, and subsidization of agency outputs are controlled through measurement of government strategic results and agency key results. There are clear incentives for performance. Many SOEs were privatized to the benefit of taxpayers and government economic and social policies.

- The remaining core public service and financial management regimes were reformed. Policy advice was separated from service delivery functions for many departments. Chief executives have time-limited contracts and specific performance agreements with ministers. Major restructuring in many sectors resulted in a 50% downsizing of the public service. Accrual accounting and charging for the capital invested in Crown organizations were part of the reform package.

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

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25 See (New Zealand Treasury 1987; Steering Group 1991)
Nicaragua – structure and function diagnoses

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

Papua New Guinea – functional reviews

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

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

Tanzania reviews:

Review for agency status

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

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

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

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26 See (Wilkins 2001)
27 See (Wilkins 2001)
28 See (Wilkins 2001)
used to determine the best delivery option for each candidate. This examination also ensured that only essential government functions were retained and that executive agencies were differentiated from other forms of government-owned or funded organizations like parastatals. The case was set out in an Alternative Options Paper for approval by the ministry and notification of central authorities.

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

Organization and efficiency reviews

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

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

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

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

see: (Civil Service Reform Programme Steering Committee 1996a, b, c, d, e, f, g, h, i, j)
**Thailand – 2000 functional reviews**

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

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

**UK reviews:**

**Prior Options reviews**

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

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

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

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

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

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30 See (Wilkins 2001)
31 See (Wilkins 2001)
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- Re-examine the options considered before creating the agency in light of experience and any changes in internal and external circumstances;
- Test rigorously whether the agency function is required at all, or whether there is any scope for privatization, contracting out, transfer to another body, repatriation to the department, or continuation of agency status;
- Consult widely with agency management and staff, the parent ministry, customers, interest groups, and other suppliers of similar services;
- Assess the practicability and value for money of each option; and
- Make recommendations to the minister responsible.

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

Better Quality Services and Best Value Reviews

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

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

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

Each BQS review considers the following five options:

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

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

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See (Cabinet Office 2000a, b; Department of Environment 2001; Improvement and Development Agency 2001)
Councils may choose how to program their reviews, so long as they make, in the words of the White Paper, ‘early inroads’ into the weakest services. They may choose to prioritize reviews in areas:

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

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

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

**Market Testing**

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

The questions asked include:

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

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

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

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

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

US reviews:

‘Bottom Up’ review of the Department of Defense

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

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

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

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34 See (Wilkins 2001)
35 See (General Accounting Office 1995; Peters and Savoie 1998)
Modernization of the Federal Civil Service: Methodology for functional reviews

References


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