Modern public management in theory and practice

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1. Introduction

The public sector in countries such as the Netherlands, New Zealand, Sweden, Germany (Flynn and Strehl, 1996, contend that Germany and Swiss have not moved away from the classical bureaucracy model: at the municipal level cities such as Soest are changing,, however) and the UK, have faced spectacular changes in organization and management. In most cases the driving forces behind the various changes were the same, also for the different countries. Foremost, the prime driving force has been the budgetary exigencies: Boorsma (1993) and Mol (Boorsma and Mol,1995) speak about a "financial revolution". Dopatka (1996) in the same way mentions that the leadership in the discussion about the public administration has moved away from legal and social sciences to economics and finance. The need to redress the public sector, no matter for what reason, such as too high public deficits (the Netherlands central state, Belgium, UK) or too high taxes (many US states such as California) will always boil down to the same effect, viz. cutting down public expenditure.

The budgetary forces have, however, on their turn evoked other forces, such as:

. the call for rational, businesslike approaches within public organizations (for one of the first contributions -alas in Dutch- see Boorsma et al., 1983),
. more attention for controlling (the advice no. 1 in Boorsma et al. 1983) and accountability, as part of this more businesslike approach,
. the devolution of authority and discretionary power within public organizations from the political level to the managerial level; this devolution or internal decentralization became wellknown as self management (for one of the first contributions- alas in Dutch- see Heroverwegingscommissie, 1983),
. the call for a separation of central, key organizations for policy preparation and decision making on the one hand and more or less autonomous agencies for implementing policies on the other hand,
. the devolution of autonomy by the state to other, "lower", public authorities such as municipalities or quango’s,
. the increasing attention to the total quality approach,
. the increasing attention for the citizen’s demands (see Flynn and Strehl, 1996) and preferences, treating them like "clients" or "customers", also if they are not buying the public goods, like e.g. in the citizens’ demand for police services.

In many countries the set of changes, although triggered by budgetary causes, thus creating a "financial revolution" (Boorsma,1993, Boorsma and Mol, 1995), have encompassed many of the aforementioned changes. In different combinations (Dopatka, 1996, Flynn and Strehl, 1996b, Hood, 1991) they received the label of "Modern Public Management" or even of "managerialism" since the public managers in this approach are in a (new) position where they can and have to use management skills.(Reviewing all the changes summed up before, it easily becomes clear that some changes do not have a relation with managerial skills, like the increasing attention to citizens’ demands. For that reason the name of managerialism seems less adequate.)

Next to budgetary scarcity, another driving force has been the more or less foreseeable reaction to the outgrowth of the public realm during the sixties and seventies, the pendulum swinging back in the eighties towards the market sector. The last change force, privatization in various kinds, has received a very strong impetus at the end of the eighties due to the "fall of the wall", and the end of communism in East Europe. Summing up some of the changes in public management in western countries, without being exhaustive, most are more or less directly caused by these two forces. Another, less evident factor might be a normative one, the uprise with many citizens and public employees of the feeling, that government has to deliver value for money to the tax payers, and of the idea that it is possible to reduce inefficiency and ineffectiveness and squandering of public money.

This paper will focus on a sub-group of the group of changes in public management, which together bear the name of modern public management (MPM). No attention will be given to the total quality approach and the move towards public productivity improvement (see paper of Halachmi, same Conference), or to the decentralization of state activities and power to other public organizations, neither to privatization. Section 2 will, first of all, deal with the principal agent (PA) approach, since this theory gives a substantial part of the theoretical underpinnings, at least from economic theory. Even more important for a practitioner, the PA theory clearly distinguishes the various relations between a politician and the public manager, or between the political manager and the public manager. By giving attention to these relations, some relations will come into focus, which have been neglected in practice, with sometimes strong negative consequences. Thus it seems to be again the case: nothing is so practical as a good theory!

Section 3 will deal with the organization and budget process model as chosen by most provinces and larger municipalities in the Netherlands, and by an increasing number of cities, Cantons (see e.g. Administration 2000, 1996), and other public entities in other countries.

In the organization and budget process model, dealt with in Section 3, the relation between politician and public manager is coined in many cases as contract management (see the paper by Van der Krogt, same Conference). In this approach the budget will differ from the budget format used in former public hierarchies. The traditional input budget will be replaced by an "output budget". Section 3 also deals with such an output budget, and the concomitant performance indicators approach.

2. Principal agent approach
In traditional, neoclassical economics economic agents deal with each other via markets, using some strong assumptions, such as perfect foresight and perfect knowledge. Transactions are made frictionless, since parties know each other, know the products, etc. During the sixties a branch of micro-economics came into existence, the theory of the firm, with pioneering done by Berle and Means and Coase. The central question in this new Theory of the Firm was: why are there firms with their own personnel and hierarchies. Thus, two different mechanisms of governance were distinguished. With the theory of the firm a new body of knowledge has been developed for the last decades, the so-called New Institutional Economics (NIE). A central characteristic, distinguishing NIE from the traditional neoclassical economics is uncertainty, as opposed to perfect knowledge and foresight.

It is rather common to distinguish within the NIE three concurrent approaches, which however are overlapping: the transaction cost approach, the property rights approach, and the principal agent approach. Since this paper deals with the latter, the two other approaches are only touched upon. The transaction cost approach (see Williamson, 1975, 1985) deals with the costs of making transactions, deals with costs of searching for contract partners, of costs of making contracts and of controlling, and, need be, enforcing those. May be it makes not so much sense to name this a special approach, since the very concept of transactions(costs) might be the central one in NIE, also in the other two approaches. The property rights approach (see Furubotn and Pejovich, 1974, de Alessi,1973) analyzes the impact of different types and use of property rights on the outcome of the economic process, mainly on profit or efficiency.

In the principal agent (PA) theory (see Jensen and Meckling, 1976, Fama, 1980, Boorsma and Künneke, 1987), the relation between the principal and the agent is characterized by information asymmetry (so again: no perfect knowledge!). The principal has the power to formulate the goals, and has the power of the purse, but the agent has the power of knowledge about the production process. It might be easily understood, that such a PA relation is not only typical for the modern stock company - the stock holders being the principals, the manager being the agent -, but also for many if not most public organizations.

Turning our attention to public organizations, the PA theory will now be presented. The principal sets the goals and gives the agent a budget for the realization of the targets set. The agent, however, has the power of knowledge, which implies a discretionary room for selecting courses of action and taking decisions. One of the first problems dealt with in this theory, is the fact that the goals of the principal and the agent might not coincide. Being part of economic science, the PA theory assumes that each economic actor tries to maximize his personal welfare. Thus, the (political) principal might strive for reelection, which not necessarily might imply working for the public satisfaction. If the politician gives the citizens what they ask for, this probably will positively influence their electoral position. The assumption of private goal maximization implies for the public agent, e.g. the public manager or some other civil servant, that he will not necessarily work completely in accordance with the goals formulated by the politicians.

The discretion which the public manager has may be used for his own private benefits. In so far as their goals diverge from the public goals, there is a reduction of efficiency which is part of the so-called agency loss.

Another part of the agency loss is caused by the need for the principal to enforce its policy goals, so by controlling: the monitoring costs. For these costs it obtains, that the more intense the monitoring is, the less room there is for public servants to deviate from the public goals. There is a trade-off, with an equilibrium, beyond which the costs of extra monitoring will exceed the gain of extra goal realization. The costs of control may be distinguished into the costs of control or monitoring during the production process, or during the implementation of the budget on the one hand, and the costs of auditing, or control ex post, on the other hand.

Instead of monitoring the agent, the principal may stimulate the agent to work in accordance with the principal’s goals, by offering financial incentives. There is a trade-off again, between the gain of extra goal achievement and the extra costs of incentives.

A last part of the agency loss is the costs made by the agents to win the trust of the principal, the so-called bonding costs. Agents will apply bonding efforts to receive more trust from the principal, in order to have more autonomy and more degrees of freedom in their decisions.

In this way, we may now distinguish several vertical relations between the principal and the agent, 5 downward, and 1 upward. The downward relations are:

1. the public goals, targets and instructions given to the bureaus,
2. the budgets given to the bureaus,
3. controlling/monitoring of the bureau by the principal,
4. auditing of the bureau's finances and output,
5. giving incentives.

The upward vertical relation is the bonding by the agent.

It has been said before, that some of the relations have been neglected in practice, detrimentally to the public cause. First of all, during the sixties and the seventies, the public realm has been increased using several policy instruments, such as nationalization of private industries, public production of all kinds of goods, and subsidization of all kinds of private goods. The increasing grip of socialism on western society was embedded in a distrust of profit making private firms and belief in the benevolent politicians and civil servants. That politicians and civil servants might be interested in their own private goals, became the assumption central to the so-called public choice theory and the PA theory, developed since the two last decades. The result of this naive belief in benevolent politicians and civil servants has been: nationalized industries making a loss, public organizations working relatively inefficiently, resulting in too high budgetary burdens.

Another example of neglect of one of those relationships has been given in the Netherlands by two municipal social banks. These banks first of all have a social goal of giving help to overindebted citizens, by arranging a credit arrangement between the problematic debtor and
3a From hierarchy to a concern-sector-model

In the Dutch public sector, most provinces (out of a total of 12) and most medium-sized and larger municipalities (out of a total of approx. 635 as per January 1, 1996) have changed their organization model from a pure hierarchy into a concern- or sector-model. The top position of the former provincial or municipal secretary has been replaced by a management team (MT) chaired by the secretary, with the sector-directors as members.

A second change relates to the former central bureaus for personnel, information, organizational affairs, and finance (PIOF). In the bureaucratic model, the chief of a policy agency is responsible for the programmatic aspects of the policy, but has to leave all decisions on PIOF-aspects of the policy to the central bureaus for these affairs. In the new sector-model a director of a sector is responsible for all aspects of the policy, including the financial and personnel etc. aspects. For that reason the term "integral management" is used. A province ordinarily will have 4 à 6 sectors. The Province of Overijssel e.g. has 4 sectors or "main groups", for resp.: A. Control and Facilities, B. Welfare, Economics, and External Administrative Relations, C. Environment and Water works, D. Country Planning.

This kind of management, integral management, is the result of an approach mentioned before, the contract management or "self-management" (see Van der Krogt and Spijker, 1989). This approach had been advised in 1983 by a State Reorientation Committee in Improving Public Efficiency, named after its chairman the Committee-Verbaan (Heroverwegingscommissie, 1983). The central point was that public agencies are hindered in decision-making by the fact that for every decision many officials have to give their fiat (or "paraaat" or initials : for that reason one spoke about the initials-culture), which hinders the speed of decision-making, and erodes the sense of personal responsibility for financial consequences of the policy proposals. Thus the Committee-Verbaan advocated the idea of "self-management", meaning that each director should be responsible for the total policy, including the PIOF-aspects. Soon afterwards the term contract management was introduced, which combines this self-administration idea with the PA-insights: politicians make a contract with the managers of the bureaucratic agencies, stipulating the goals, and specific output targets, and the budget needed for this specified output. In this contract the public managers keep greater discretionary room for taking the decisions: the politician decides on "what", and the public manager decides upon "how".

3b The output budget (process)

To understand the subsequent changes in budgeting, the systems-approach is used. In this approach one distinguishes between inputs, throughput, output, and outcomes. Inputs are the means of production, either in physical terms (number of personnel, or of machines, etc.) or in money terms (costs, outlays, budget). The throughput is the complex of the production process, of the activities to change the inputs into the output of goods (or services). The output consists of the goods/services produced. For a car factory the output is the production of X cars of type I and Y cars of type II, etc. For the production of services there are special problems in defining the output. In many cases the output is defined in the same way as the activities, or the throughput. What e.g. is the output of a tax consultant, or a medical doctor? Or a police officer? Since the public output in most developed countries consists for a very large part of services, the problem of identifying and measuring the output is a dominant problem, not only for budgeting but for other topics as well, such as efficiency improvement. The outcome is the impact on the goals, but the impact may comprise effects on other conditions as well. For some services like police or health it is sometimes easier to make a statement about the outcome of a policy measure, than about the output. Although it is hard to measure the output of health care, the outcomes might be measured in terms such as a decline in infant death, or the increase of average age, or the decline in number of death cases caused by cholera or lung cancer, etc.

In the hierarchy model, a budget typically was characterized as an input budget, distinguishing between many economic classes of different outlays, specifying for each organizational unit the amount of salaries, of social security outlays, the funds permitted for energy, for telephone, for travel, for buying materials, for investment, etc. This input budget is known in American literature as a "line-item-budget". In a law or set of rules on budgeting and accounting procedures, there will be specific rules for transferring a surplus from one budget-line to another budget-line, etc.

In MPM with its sector-model, the budget format chosen, principally will be the output budget, if it is possible at all.

Problems associated with an output budget are first, the identification of outputs: which are the products resulting from the production process (for the relation between various types of budget and product identification or output measurement, see Mol, 1989)? If it is not possible to identify outputs at all, an activities budget had to be substituted for the output budget, stating the levels of various activities and the budgetary amounts needed. If within an output budget it is possible to identify the output, a second problem lies in the measurement of the output level. Are the output units homogeneous? Are they of the same quality? Again, if the problems in measuring the output are too large, one might prefer a throughput (activities) budget.
In the contract management approach, an interesting issue is that of giving incentives, positive and/or negative ones, to a bureau or to a manager. Since a public organization cannot use the incentive of a profit share, used in a stock company, other incentives have to be found. In this context the incentive of the budget type is mentioned: if a manager is doing well, in performing according to contract, there is the reward of discretionary freedom: the manager can apply his managerial skill and take decisions in full responsibility. In doing so, it is clear that the market value of the manager will increase! If the manager is not performing well enough, the sanction might be a reduction of the discretionary freedom: his budgetary freedom (or other freedoms) will be restricted by instructions, limits, etc. and in the end the budget might be changed into an activities budget, where it is ordained which activities have to be fulfilled, at which levels, and at which budgetary costs. Or the integrality of management will be restricted, e.g. in the F-part (out of PIOF).

In the sector model mentioned before, different budget types are used.

a. First of all, the (political) relations between the Council on the one hand and the executive politicians (provincial deputies or municipal aldermen) on the other hand, are budgetary laid down in a policy budget. Such a budget formulates for the policy fields, the goals to be pursued, the specific annual targets, and the budgetary amounts permitted. Note, that such a policy budget may be interpreted as a political contract between the principal (= council) and the agent (= executive power: provincial deputy or municipal alderman).

b. Second, the policy budget will be transformed into a more specified budget, let us say a product budget, stating the different types of output needed to realize the agreed upon goals, thus the agreed upon outcomes, and stating the budgetary funds needed for the production of these outputs. This product budget on its turn may be seen as a contract between the principal = executive politician and the agent = public manager of the bureau.

c. A third budget might be distinguished, although in practice this budget might overlap with the former product budget, viz. the activities budget. This budget further specifies the product budget into detailed sub-choices as to the specific activities to be performed, in order to realize the output goal, the specific work processes to be followed, and will again give the required budgetary funds. In its turn, the activities budget may be interpreted as a contract between the principal = public manager of the agency, and the agent = civil servants working in the agency.

A budget with goals formulated, and specified products per policy goal, has been internationally known as the Tilburg model (see e.g. Mix and Herweijer, 1996), named after the budget format chosen in the city of Tilburg. AS a matter of fact, in the Netherlands after the pioneering works of (Heroverwegingscommissie, 1983, Boorsma et al., 1983) the process of further developing MPM has been carried on especially in the larger medium-sized cities of Delft, Groningen, and Tilburg. Later followed the larger city of Rotterdam with a so-called Planning and Control Cycle.

In the budgetary process, in the first phase of budget preparation, these budget documents are drafted and authorized. In the following phase of budget implementation, the principals will normally apply some monitoring, which in the MPM-model, elaborated upon in this contribution, will be done by management reports, monthly or quarterly reports, giving information not only on the expenditures and income realized at the moment, compared with the budgeted amounts, but also on the realization of the performance (be it activities, or outputs, or outcomes). As usual with other, more traditional budget types, after the ending of the budget period, the accounts will be drafted, audited, and authorized.

The new budget format, be it according to the Tilburg model, or the model as used by most provinces or municipalities, will not only formulate goals, but will also state the products to be expected, the type and the quantity. The Planning and Control Cycle approach followed in Rotterdam stated that for each bureau the same budget format should be chosen, giving info on the product type, on the spending and the income, on the income-outlay-ratio, and on performance indicators.

A product normally has many specifications. In order to describe the output wanted, the budget document will use performance indicators. Such indicators may be given for the outcomes, and/or output, and/or activities, and for the input. To give an impression of the relative performance, indicators may be given for the effectiveness, and for different efficiency and productivity measures. The Dutch law on State Budgeting and Accounting Procedures stipulates that the budgets should give information on the output realized by "inputting" the budget. There is a separate set of Rules for Budgeting and Accounting for the Provinces and municipalities, containing similar stipulations. It has, anyhow, become commonly accepted to add to the budgetary documents indicators on output etc. and on efficiency.

Although the outlined approach is nowadays generally accepted in the Netherlands, and on an increasing scale in other countries, the implementation still faces problems: one may change the procedures and the format and other outer appearances of the budget process, there are still barriers to be taken, in one city or province more than in other.

One of the barriers is the reluctance of politicians in the council, being representatives, to refrain from dealing with aspects of implementation of policies, with the "how to" questions. In many cases they still might raise questions about the choice of activities or the choice of production means, or about budgetary details. Another role problem is found with the executive politicians in charge, who have to monitor the sector managers during the process and afterwards, to control if the targets agreed upon have been realized. There are still many cases where the deputy or alderman draws up a budget with detailed targets as to different products to be realized, and who during the budget implementation leaves the set of contracts in the bureau desk!

Another problem is that the executive still may have the inclination to meddle with the managerial set of decisions, sitting so to speak on the managers' chair.

For such and other reasons there might be a divergence too between the new public management as formally documented on the one hand and daily practice on the other hand (see Flynn and Strehl, 1996, p.5). Although those problems are encountered in practice, there hardly seems to be a better alternative nowadays: the concernmodel with integral management is widely accepted, there are problems with incentives and with formulating products in certain areas. Thus, the new practice will find some modus operandi, combining -I hope- the
best of different approaches.

LITERATURE

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