Chapter 7

Uncoupling

Creating Clarity of Role by Separating Steering and Rowing

Definitions pp. II/119

Uncoupling **separates policymaking and regulatory roles (steering) from service delivery and compliance roles (rowing), while also separating service delivery functions from compliance functions. This helps steering organizations concentrate on setting direction and frees rowing organizations to concentrate on achieving one or two clear missions.**

The U.S. Federal Aviation Administration (FAA) faces one of the most complex tasks of any government agency in the world. With 352 air traffic control (ATC) towers, hundreds of radar facilities, and 36,500 employees, it handles 200,000 aircraft takeoffs and landings every day. It has more than 30,000 technological systems, uses more than 40,000 aeronautical radio frequencies, and conducts more than 11,000 flight inspections every year. It regulates an aviation industry that produces 6 percent of the nation's GDP. The lives of millions of Americans—and foreigners—depend on its performance.

Yet the FAA is a troubled organization. A vast computer modernization program begun in 1981 is more than 10 years behind schedule. While other nations import sophisticated American computer technology for their own ATC systems, the FAA still imports vacuum tubes for use in a few of its ancient computers. "Antiquated backup systems cannot be expected to provide needed safety assurance as communication and radar failures become a more frequent occurrence," warned a December 1997 report by the National Civil Aviation Review Commission, chaired by former congressman Norman Mineta. "Just between 1992 and 1996, the number of hours of unscheduled outages more than doubled."

Because of such equipment failures, airline delays forced by the ATC system are increasing. By 1997 they were costing the airlines more than $2.5 billion

a year, according to the commission. Yet FAA investments in technology are shrinking: "Between 1992 and 1997, the effective buying power of the FAA's capital budget has decreased nearly 40 percent."

The FAA's problems have been studied repeatedly for at least 15 years; indeed, the FAA has been "commissioned" to death. There is significant consensus about the basic problem: air traffic control is a massive, complex, technology-intensive service business operating within a conventional U.S. government bureaucracy. "The FAA is unique for a government agency in that it provides around-the-clock, 365–days-a-year air traffic control services—a linchpin of our nation's economic well-being," the Mineta Commission explained. "However, the FAA is funded and budgeted like other government agencies, most of which do not have this type of operating responsibility." It is a bit like putting a Ferarri engine into a dump truck body and still expecting it to win races.

Until 1996, the FAA operated within exactly the same constraints as every other federal organization. Bureaucratic procurement rules frustrated its efforts to modernize its massive computer systems, and arcane personnel rules so limited its flexibility to move, pay, and promote people that some of its busiest centers were chronically understaffed. Federal budget rules made it difficult to move money where it was most needed as problems emerged, and federal budget caps made it impossible to spend billions of dollars sitting in the Airport and Airway Trust Fund, all of it raised by taxes and fees on airline passengers, shippers, and operators. As a result, the agency had to "forgo capital development programs in order to keep the day-to-day operations adequately staffed," the Mineta Commission reported.

On top of all this, the FAA has long suffered from having dual, conflicting missions: promoting commercial aviation through service functions like ATC and airport grants, while also enforcing compliance with safety rules. Both missions were intended to create a safe system, but one requires FAA managers to support the airline industry, whereas the other requires them to police it. Whenever a commercial airplane crashes, critics charge that the agency is doing too much promoting at the expense of enforcement and safety.

The FAA's ATC division operates the air traffic control system, writes the rules (such as how far apart airplanes must be during takeoff, landing, and flight), and enforces compliance with those rules by its own employees. This form of self-regulation has been questioned for years. As the Aviation Safety Commission said in 1988, "Both safety and public confidence in the safety of the system might be enhanced if greater separation existed between the functions of regulating the ATC system and operating it."

Indiana University professor Clinton Oster Jr. explains the basic problem:

FAA has two goals in operating the air traffic control system and these goals can often pull in different directions. One goal is to operate the air traffic control system safely. The other goal is to provide enough capacity to avoid excessive and persistent delays.... [Some] capacity-related decisions such as aircraft separation standards and the conditions under which various runway configurations are used can pose a tradeoff between safety and capacity that FAA must make.... With the current form of self-regulation, these tradeoffs are made internally, without any meaningful review from outside the organization and without a public forum in which the regulatory decisions are reviewed and justified.

Oster offers the FAA's policies on overtime work as an example of how self-regulation can lead to different treatment than regulation by an external body. "While FAA carefully regulates the amount of time pilots can fly within specified periods and does not allow the airlines exceptions to these duty time regulations," he points out, "FAA allows, and in the past has even mandated, considerable overtime for air traffic controllers."

Oster recommends uncoupling ATC operations from ATC regulation. He notes that Canada, New Zealand, Australia, Portugal, South Africa, Singapore, the Czech Republic, and Latvia have all done this over the past decade. Most have created public corporations to handle ATC operation, while leaving regulation of the ATC system and enforcement of compliance in the hands of a normal agency.

In 1993, the National Commission to Ensure a Strong Competitive Airline Industry, chaired by former Virginia governor Gerald Baliles, recommended moving ATC operations into a public corporation, to accomplish the same separation. Later that year, the Clinton administration's National Performance Review (NPR) seconded the proposal. This solution would have taken the service business of ATC out of its bureaucratic straitjacket, the NPR argued, leaving the rest of the FAA to "focus on regulating safety"—thus giving each separate entity a much simpler, clearer purpose.

The Clinton administration pressed the case on Congress, but there was little support within the Democratic leadership for fundamental change. By 1996, however, air traffic problems were so acute that Congress exempted the FAA from normal personnel and procurement rules and attempted to remove the inherent conflict between promoting commercial aviation and enforcing safety rules by removing the word *promoting* from the FAA's authorizing legislation.

But ATC remained within the FAA, and the agency still combined its service, regulation, and compliance functions in one division. Meanwhile, budget restrictions kept one arm tied behind the agency's back.

Understanding that Congress had already rejected a public corporation, Mineta and his colleagues recommended another way to separate air traffic control from the larger FAA. They suggested uncoupling ATC operations from policy and regulation by turning ATC functions into a performance-based organization (PBO), an organizational model championed by Vice President Gore.

See Banishing Bureaucracy pp. I/4-10

Gore had modeled his PBO proposals on the Next Steps initiative in the U.K., which by 1998 had created 138 uncoupled agencies. These "executive agencies" were uncoupled from their policy-focused departments; given clear purposes; awarded significant budget, personnel, and procurement flexibility; and made accountable for their performance against quantifiable targets. Under Gore's scheme, functions that had clear service or compliance missions, measurable activities, and proven capacity to measure their performance would be set up as PBOs, just like Britain's executive agencies. They would have flexibility to manage their own personnel, procurement, budget, real estate, and other operational issues—within very broad civil service, procurement, and budget parameters. They would be managed by chief executives hired through a competitive search, paid a base salary of $150,000, and eligible for up to $150,000 more in performance bonuses. They would focus on carrying out their service or compliance functions, leaving most policy decisions to the departments that oversaw them. And they would negotiate three-to five-year agreements with their mother department, spelling out their performance targets, flexibilities, and consequences for performance.

The Mineta Commission recommended that an air traffic PBO be removed from federal budget caps, funded exclusively from fees paid by those who used the system, and given the power to borrow. "The ultimate goal," it said, "is to create an executive structure where broad policy issues are determined by policy officials and operational and financial issues are managed by the Chief Operating Officer" of the new PBO.

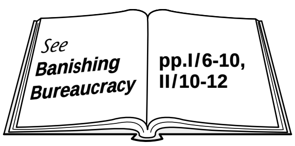
Organizing for Clarity

The FAA is a classic example of why uncoupling is necessary to achieve clarity of purpose in so many government organizations. Particularly in larger governments, multiple functions with different purposes often cohabit in the same organization. All are managed in the same way, using the same administrative systems and rules and subject to the same constraints. The same organization is often involved in policy work, service delivery, and sometimes even compliance work. Inevitably, some of these functions suffer, because they can't operate well within the constraints of the larger organization. Sometimes two

different functions, such as service and compliance, conflict with each other: the same organization is supposed to serve its customers (such as airlines) while also regulating them and enforcing the rules they must follow. Meanwhile, the lengthy chains of command so often found in the public sector make it hard for managers of discrete functions to get decisions ratified. And the reality of having too many bosses means the organization is pushed this way and that, with no one person ultimately able to make decisions and be held accountable for them. With so many interest groups pushing on elected policymakers, legislators tend to pile on ever more missions, creating less and less clarity of purpose.

This problem is epidemic in the public sector. Congress asks the national forests to serve mining interests, timber interests, recreational interests, and local community interests—all at the same time. Since it formed the Agency for International Development (AID) in 1961, Congress has given it nearly 40 different missions—everything from promoting rural development, education, and agriculture to protecting human rights and endangered species. Some of these missions conflict, and taken together, they offer AID managers what the General Accounting Office has called "a complicated and incoherent set of objectives with no clear priorities." State and local organizations often house service and compliance functions side by side, telling one set of employees to meet their customers' needs while their colleagues enforce regulatory rules on them. Even school districts, which would seem to have fairly obvious purposes, get saddled with mission after mission: educating students, combating segregation, feeding the poor, inoculating children, delivering social services, operating daycare facilities, and on down the list.

Uncoupling is meant to sort out these multiple missions by separating steering from rowing and placing different rowing functions into different organizations, each with one or two clear missions. *Banishing Bureaucracy* described at length how both the British and the New Zealanders did this. New Zealand took many of its large departments apart, leaving policymaking ministries separate from service and compliance departments. The British, through their Next Steps reforms, kept the uncoupled agencies within their departments, but gave them an arms-length relationship outlined in a five-year "framework document."



In the U.S., Canada, and other countries, national, state, provincial, and local governments have also begun uncoupling. The exercise creates certain costs: performance agreements must be negotiated, performance must be measured, and periodic reviews must be conducted. But these transaction costs are the price one must pay for clarity about role and direction and accountability for performance. In return, uncoupling can create enormous value.

At the simplest level, it allows each organization to concentrate on a clear mission. It helps elected officials and their top political appointees focus on steering—on policy issues—while freeing managers to focus on running their operations. Peter Drucker long ago noted that successful organizations separate top management from operations, so as to allow "top management to concentrate on decision making and direction." Operations, Drucker said, should be run by separate staffs, "each with its own mission and goals, and with its own sphere of action and autonomy." Otherwise, top managers will be distracted by operational tasks, and basic steering decisions will not get made.

In government, the danger is even greater, because the temperaments required to succeed at governing and managing are so different. "I always say, management is about the head, government is about the heart," explains Terrence Musgrave, chief executive in the London borough of Bexley. Good politicians don't usually make good managers, and vice versa. And "if politicians spend their time managing, then who the hell is minding government, making long-term decisions, setting priorities? Managing a provider function can be a massive diversion from your primary role of figuring out what those people out there need."

The British Model

In 1988, Margaret Thatcher's Efficiency Unit released a seminal report: *Improving Management in Government: The Next Steps.* It recommended carving operational agencies out of the U.K.'s large departments and giving each one a clear mission, an accountable chief executive, quantifiable performance targets, and significant management flexibility. Thatcher backed this plan to the hilt, and today more than 75 percent of civil servants in the British national government work in these uncoupled agencies.

As it worked out in practice, the reform:

- Separated departments' service delivery and compliance functions into discrete units called executive agencies.
- Gave those agencies much more control over their budgets, personnel systems, and other management practices.
- Installed chief executives for the agencies, normally hired through a competitive search process open to the private sector (a radical break with past practice).
- Paid chief executives whatever it took to get the talent needed, including performance bonuses of up to 20 percent of their salaries, but denied them the normal lifetime tenure of a civil service job and required them to compete for their jobs every five years.
- Required chief executives to negotiate with their departments five-year "framework documents" specifying the general results their agencies would achieve and the flexibilities they would be granted; draft annual business

plans with objectives, performance targets, and planned investments; and produce three-to five-year corporate plans spelling out their longer-term business strategies.

- And put agencies on trial for their lives every five years through "prior options reviews," which asked whether the agency or its individual functions should be abolished, sold to private owners, merged with another agency, or restructured.

The first executive agency was the Vehicle Inspectorate, carved out of the Department of Transport. A compliance organization, it keeps the roads safe by performing annual tests on heavy-goods and public service vehicles; oversees the annual testing of automobiles, motorcycles, and light-goods vehicles by private garages; and enforces the laws on roadworthiness, vehicle weight, and commercial drivers' hours, primarily through roadside inspections. It came first because the department had almost privatized several of these functions. After choosing not to privatize, departmental officials decided to restructure the functions on a more businesslike basis. When the Next Steps white paper was released, the division's director, Ron Oliver, jumped at the opportunity it presented to deepen the change process he had already launched.

As a guinea pig, the Vehicle Inspectorate was the first organization to negotiate a framework document—to put down on paper its mission, its responsibilities, its accountabilities, and its flexibilities. "What I was responsible for and accountable for had never been in any way described to me," Oliver remembers.

> *It was a very vague situation. In a sense the whole civil service was very vague, because that's how it operated. Now for the very first time I knew exactly what I was responsible and accountable for. That was the single biggest change: suddenly I felt I was responsible and accountable.*

It wasn't just Oliver who thought accountability had been too vague; departmental leaders agreed. "Under the old regime responsibility was diffuse," Permanent Secretary A. P. Brown told Parliament in 1991. "It is no longer diffuse."

> *Mr. Oliver and all who work with him are now absolutely clear as to what their objectives are, what is required of them. . . . It also has efficiency targets which are probably much more explicit than they were in the old days. . . . They do have a clarity which allows them as managers . . . to go on with the job without interference from the Department, without always having to ask senior officials or occasionally Ministers for decisions on things which really are managerial rather than policy.*

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In addition, the agency got a few management flexibilities, including the right to purchase several internal services from private vendors rather than the department, and the right to create a gainsharing program. If the organization exceeded its annual efficiency target, 50 percent of the excess savings went to the staff.

Later, as the Next Steps reform process deepened, Oliver won significantly greater flexibilities: the right to operate as an enterprise fund, which gave him financial flexibilities such as the right to borrow from the department and the right to carry funds forward from one year to the next; authority to redesign the personnel rules, including the pay and grading system, for all but senior executives; and the authority to do all bargaining concerning pay with the unions.

Oliver and his team used their new framework to restructure the way the entire organization carried out its business. They started with "the relatively easy changes, the structural changes," Oliver remembers. "We cut the whole of the country up into 53 accountable management areas." Each one had a team. "We brought in all the systems to measure their performance and compare their performance from one district to another."

They worked with 100 managers from across the organization to prepare a mission statement, which included a vision statement and four basic goals. They removed a tier of regional directors from the management structure. They devolved more responsibility to the districts and worked to get more employees involved in decision making. They competitively bid out, or "market-tested," a number of services. And after the department merged another function into the agency in 1991, they trimmed their staff by 20 percent over four years.

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Oliver and his staff worked out an efficiency measure based on unit costs, called the Aggregate Cost Efficiency (ACE) Index. The department set aggressive targets for annual increases in efficiency, and year after year the agency exceeded them, averaging 4.5 percent a year over the first eight years. (These results were audited and confirmed annually by the National Audit Office.) During the agency's first three years, employees took home gainsharing bonuses of up to £213 (about $350) a year.

On the quality front, Oliver and his team opened test centers on Saturdays; published information about the contents of the tests for the first time; instituted prefunded accounts for transport businesses, so they would not have to pay each time one of their fleet was inspected; increased the number of privately run testing facilities available to vehicle operators; and dramatically increased staff training. By 1991, a customer survey commissioned by the National Audit Office showed that 91 percent of heavy-goods and public service vehicle operators and private inspection garage owners considered the inspectorate's overall service either fairly good or very good. More than 40 percent thought it had improved over the preceding three years, whereas very few thought it had grown worse.

Oliver and his agency went on to commission their own customer surveys, create customer service standards, train employees to analyze and solve problems using Total Quality Management methods, create an advisory board broadly representative of the various compliers with which they dealt, and develop a "balanced scorecard" of performance targets at all levels of the organization, which included measures of customer satisfaction; agency quality, effectiveness, and efficiency; return on capital; contributions to road safety; and the long-term development of the inspectorate.

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In April 1990, the Department of Transport set up three more executive agencies, which began to produce similarly dramatic improvements. In 1992 it created a fifth, which it sold. In 1994 it created three more; in 1998 it merged two of them; and in 1999 it announced plans for a seventh executive agency.

The Advantages of Uncoupling

As the Vehicle Inspectorate example illustrates, uncoupling is really very simple. It separates the steering functions of setting policy goals and deciding how to achieve them from the rowing functions of providing services and enforcing compliance. When these roles are separated, each organization's mission becomes much clearer. And when that happens, it becomes much easier to measure how well those missions are being accomplished and to hold managers accountable for their organizations' performance.

Before uncoupling, the typical organization looks like the illustration in Figure 7.1. If this organization were a state commerce department, for example, the director and his or her deputies would be responsible for steering: carrying out the policy goals of the executive and the legislature, measuring whether the department's activities were achieving those goals, evaluating why or why not, and recommending appropriate policy changes. But they would also be responsible for managing the department. They might have nine divisions, agencies, and the like, some focused on regulating the business community, others providing services such as small business development centers, loan funds, a venture capital fund, and a grant program for municipalities. There would also be a personnel office, a budget office, a procurement office, and perhaps an equal opportunity office. All of these activities would be run by employees of the department. Hence the director and his or her deputies would both manage these employees and evaluate whether their units should continue to exist. Not surprisingly, few directors would ever recommend closing down a unit because an alternative outside the department might work better.

After uncoupling, the department might look like the one in Figure 3.2. Now the department would be much smaller: it would consist of a director, a few deputies, a policy staff, a contracting unit to negotiate performance contracts with other organizations, a performance measurement and evaluation unit, and a small administrative services unit that would deal with budget, personnel, procurement, and other administrative issues. The department would be a true steering organization: it would decide what strategies to use and which organizations, if any, to contract with to execute those strategies. But it would not implement any strategies itself. As the figure makes clear, it might contract with three state agencies, two private nonprofit organizations, and two for-profit firms to implement different strategies. It might also provide vouchers to small businesses, to buy management assistance, and grants to municipalities for community development work. The department's performance measurement and evaluation unit would monitor how well each strategy and organization was achieving its mission and goals, and why. It would recommend to departmental leaders when to reexamine or change strategies or hire different contractors.

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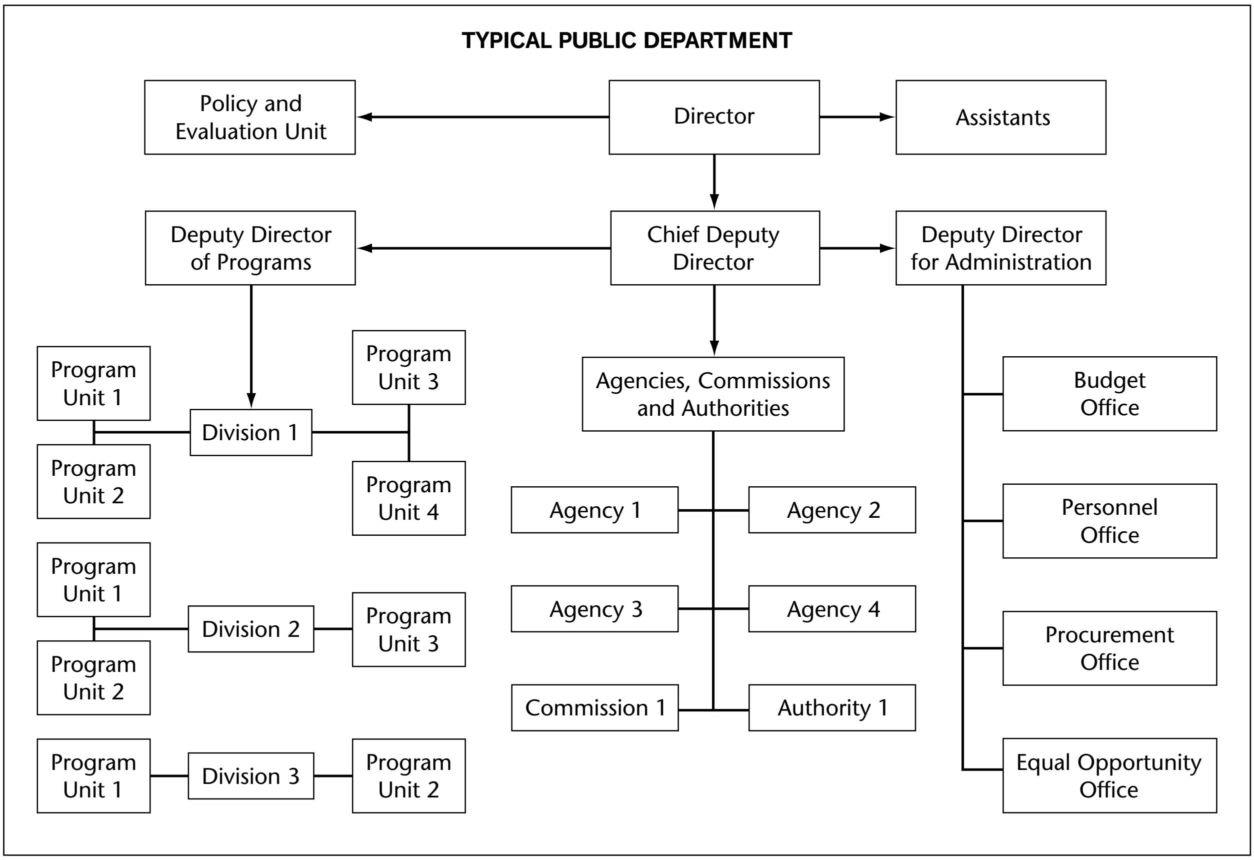
Figure 7.1.
Typical Public Department
Before Uncoupling



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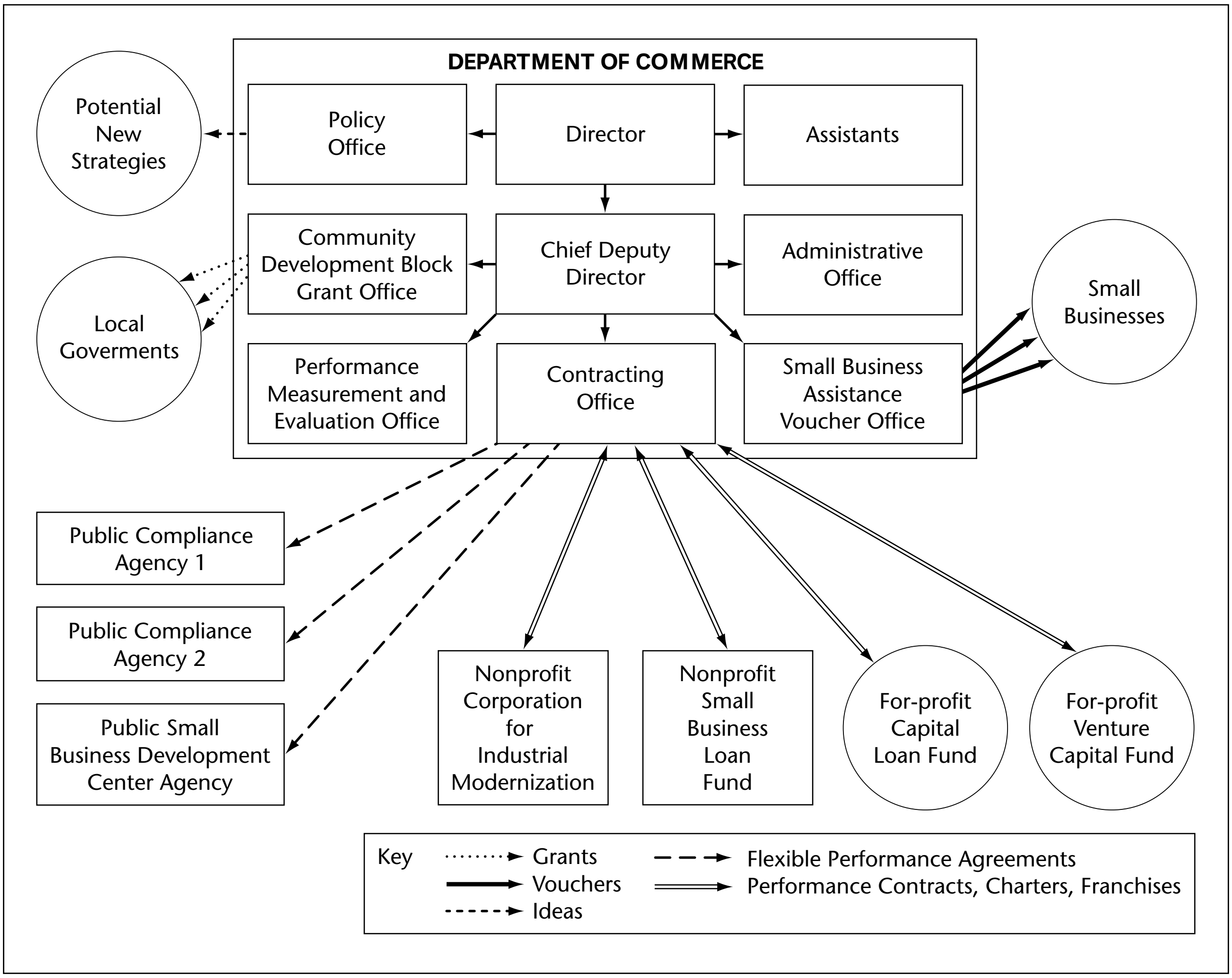
The governor would recommend the department's budget and the legislature would appropriate it. The budget document would list the outcomes the department was expected to produce. But it would be the department's job to decide what to buy with that money: which strategies to fund and which organizations to hire to execute them. This uncoupling of funding from operations is known in the British Commonwealth countries as *separating purchasing from providing.* It is not always done; sometimes the steering organization simply advises the executive and legislative body, and they appropriate directly to the rowing organizations. But a legislature would get far more leverage to improve outcomes by appropriating money only to the steering organization—because that would leave the steering organization free to choose whatever combination of strategies and organizations it believed would most effectively deliver those outcomes.

Figure 7.2.
Typical Public Department After Uncoupling



See *Reinventing Government* pp. 290–298, 332–342

Reinventing Government described 36 different options such a steering organization could use to achieve its desired outcomes, including the following:

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- Contracting with a private nonprofit or for-profit organization.
- Contracting with another government.
- Creating a public corporation funded by its customers.
- Franchising private providers.
- Taking regulatory action.
- Creating tax incentives or disincentives.
- Providing subsidies to private producers (grants, loans, equity investments, favorable procurement policies, favorable investment policies).
- Offering subsidies to consumers (vouchers, tax credits).
- Sharing risk with private producers (insurance, loan guarantees).
- Catalyzing voluntary community action.

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We describe how to use several of these options in other chapters of this book, as indicated by the pointers in the margin above.

By giving steering organizations the freedom to choose different strategies, separating purchasing from providing breaks the monopoly most public organizations enjoy. It gives policymakers the freedom to look elsewhere for solutions. The British, Australians, and New Zealanders call this "contestability." In the words of former British minister William Waldegrave, contestability "ends potential conflicts of interest and allows the purchaser—health authority, council, local education authority or whatever—to become the advocate of the consumer, rather than the defender of the producer."

Consider the case of an elected school board that employs all of its district's administrators, teachers, custodians, bus drivers, and aides. Its job is supposed to be to run the system in the best interests of the students. But when those interests conflict with the interests of employees, as they sometimes do, school board members know which of the two constituencies is unionized, which organizes at election time, and which votes. Indeed, district employees typically vote at much higher rates in school board elections—which often have very low turnouts—than does the rest of the community. So when conflicts between students' and employees' needs surface, the employees usually win. If schools were uncoupled, however—if districts contracted with a variety of organizations to run schools rather than employing their staffs directly—the balance of power would shift. Most policy changes would produce both losers and winners among the service providers hired by the district; hence, they would tend to balance each other in the political process. (A decision to contract with more Montessori programs would be seen as a threat by traditional programs but a boon to Montessori schools and teachers, for example.) In addition, providers would be less willing to oppose school board members at election time, for fear of antagonizing them and jeopardizing future contracts.

In 1999, the Education Commission of the States proposed this model as a serious alternative for school boards to consider. Boards would negotiate three-to five-year charters with organizations to operate schools, rather than owning their own schools. Milwaukee, the nation's 12th largest district, now has not only charters but also contracts and vouchers, while the board also operates many of its own schools.

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Uncoupling purchasing and providing also "forces both sides to define the nature of the service and the standards of quality which are to be provided," as Waldegrave explains. It then helps those doing the steering demand better performance from rowers and back it up with consequences, both positive and negative. "The greater the distance between Ministers and managers, the more independent and demanding the government can be as a purchaser of outputs and enforcer of accountability," notes American public administration expert Allen Schick, in his exhaustive evaluation of New Zealand's reforms.

Uncoupling also helps minimize political interference and corruption in public services. William Eggers described in *Government Executive* magazine what happened in New Zealand after uncoupling:

> *Lobbyists used to line up outside New Zealand Cabinet meetings to wait for their opportunity to ply ministers for special privileges. This doesn't happen anymore. . . . Because the chief executives [who are appointed by a neutral body, the State Services Commission, not by elected officials] have complete control over the mix of inputs they use to produce outputs, from road construction to science spending, the mix of projects funded is determined solely on a cost-benefit analysis, by the relevant agencies. "With our system, there is no political interference on where the money goes for roads," says Stuart Milne, the chief executive of the Ministry of Transport.*
>
> *"I couldn't imagine having people coming through this office all day lobbying for special favors," says Simon Upton, a member of Parliament. "Our new system is a good security against corruption in politics."*

In sum, by funding steering organizations to achieve outcomes and letting them choose which strategies and rowing operations to engage, governments make it far easier to steer effectively. The legislature's role shifts to defining the outcomes it wants and appropriating money to steering organizations,

which are responsible for achieving them. Although this takes management decisions out of the hands of elected officials, it makes it far easier for them to use the steering tools described in Chapter Five. It has many other advantages as well, as described in *Reinventing Government* and *Banishing Bureaucracy*.

OTHER ADVANTAGES OF UNCOUPLING

- "Freeing policy managers to shop around for the most effective and efficient service providers helps them squeeze more bang out of every buck."
- "It allows them to use competition between service providers."
- "It preserves maximum flexibility to respond to changing circumstances."
- "Steering organizations that shop around can also use specialized service providers with unique skills to deal with difficult populations."
- They "can even promote experimentation and learn from success."
- Finally, they "can provide more comprehensive solutions, attacking the roots of the problem. They can define the problem in its entirety—whether it is drug use, crime, or poor performance in school—then use many different organizations to attack it."

—From *Reinventing Government,* pp. 35–36.

- Uncoupling also creates "smaller, more focused organizations 'with short chains of command.'"
- "'Focused units have the advantage of being able to provide much more clear information about their resource use, as the separation forces the allocation of assets to specific activities. It is thereby easier to generate information about the real costs of services.'" (Quoting New Zealand reformer Graham Scott.)

—From *Banishing Bureaucracy,* pp. 98–99.

Uncoupling Within Rowing Organizations

Uncoupling can actually take place at several levels. We have discussed how it works at the highest levels, by separating steering from rowing and service from compliance functions. But at the next level, each service or compliance organization can also uncouple its role as a purchaser from its role as a provider. It can use other mechanisms to get services provided, including vouchers and contracts with private organizations. Many "rowing" organizations contract out distinct functions—maintenance, data processing, groundskeeping, printing, and the like—to cut costs. In the U.K., "Parts of Agencies are increasingly being

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contracted out to private firms, often for long periods," according to a survey done by Price Waterhouse. Rowing organizations can even set some of their functions up as internal enterprises, using the enterprise management approach.

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Often service organizations contain small compliance functions, or vice versa. In such cases, they can set up small pieces of their organization as distinct units, operating on performance contracts much like the flexible performance frameworks discussed later in this chapter. A tax collection agency might create a distinct unit to handle a service function such as providing telephone assistance for taxpayers, for example. A police department might do the same for the service unit that handles its 911 calls.

Similarly, when large organizations cannot uncouple, for political or other reasons, they can still separate distinct service and compliance functions into different divisions, to give each division more clarity of purpose. British leaders decided not to set up their tax collection organization, Inland Revenue, as an executive agency, for example. But Inland Revenue's managers liked the Next Steps model, so they reorganized into 30 units, all structured as if they were executive agencies but all still within Inland Revenue. In New Zealand as well, reports Allen Schick, "When conglomerate departments remain intact, the preferred practice has been to restructure their components (including the policy unit) into separate business units, each with its own objectives, performance targets, business manager, and operating budget."

Many managers do versions of this on an informal basis. A department head may negotiate informal agreements with his or her division managers. Or an enterprising division manager may propose a deal to his department head: "I will agree to produce a quantum leap in performance, as measured by these indicators, if you will let me run my own business—and give me waivers to *x, y,* and *z.* If I haven't produced a quantum leap in two or three years, let me go." But such informal agreements don't uncouple purchasing and providing; they don't give department heads the easy option of going elsewhere for the service in question. They also work only for those managers who have the organizational savvy to create and manage such a relationship. And they force even those managers to put a lot of wasted energy into circumventing budget offices and personnel rules. As we argue later in this chapter, creating a formal, written agreement to uncouple has many advantages.

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Uncoupling Regulatory and Compliance Functions

Few people make a distinction between regulatory and compliance functions, but as we argued in *Banishing Bureaucracy,* the distinction is just as useful as that between setting policy and delivering services. We define regulatory organizations as those that write the rules society must obey (a steering function), whereas compliance organizations enforce those rules (a rowing function). Just as it is wise to separate policymaking from service delivery, it is also usually wise to separate writing the rules from enforcing them.

The easy example is law enforcement. If society let the police write some of its laws, it might soon experience problems. Because police spend much of their time dealing with criminals, they often develop rather dark views of humanity. And because their job is to catch criminals and help the courts convict them, they desire laws that make that job easier—even if they impinge on individuals' rights. Most would agree that we are all safer if neutral bodies that can reflect all of society's interests—such as legislatures—write the laws.

Some areas are so technical that legislators write relatively broad laws and leave it to regulatory agencies to draft the regulations that flesh them out. This is true in environmental policy, where the Environmental Protection Agency and its state counterparts play a significant rule-making role, and in regulation of the financial markets, where the Securities and Exchange Commission and other bodies write many regulations. In such areas, society is also better off if rule making is separated from enforcement. Even in reinvented compliance agencies that have embraced a strategy of winning voluntary compliance, the perspective of agency staff will reflect their experience and desires, not the totality of society's interests. Consider an Occupational Safety and Health Administration officer who wants to make life better for industry by changing a rule regarding a chemical that has been proven safe in the workplace. Will that officer know whether the chemical is safe once it gets into the groundwater? We think it is better to have a neutral regulatory body that can hear all sides of every question write the rules, while a separate body enforces them. When one organization both writes the rules and enforces them, as the FAA does for air traffic control operations, there is too much room for institutional bias to creep into the decisions.

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(Admittedly, there are gray areas here. It will often make sense for a regulatory body to give a compliance organization some discretion to write minor regulations or interpret its rules differently in different areas, for example. But in our opinion it is best if that discretion is spelled out clearly and publicly by a separate regulatory body, rather than being worked out behind closed doors within one agency.)

There is a price to pay for separation, of course. Unless compliance agencies keep the rule makers well informed about what is happening on the front lines, the rule makers will not be able to write effective rules. The greater the distance between the two types of organizations, the more likely the rule makers are to write rules that are too rigid, too black and white. When that happens, compliers will become angry, voluntary compliance will plummet, and compliance organizations will have great difficulty enforcing the laws. The solution is to create mechanisms to ensure continuous, significant communica-

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tion between regulatory and compliance bodies. We return to this topic later in this chapter.

The Challenge of Steering Well

The greatest challenge in uncoupling steering and rowing is getting the steering side to do its job. Virtually every government that has tried uncoupling has run into this problem. Steering is hard work, and for most public sector leaders, it is new work. Few city managers, county executives, governors, department heads, steering board directors, or ministers have either the skills or the desire to steer effectively. The strategic management tools discussed in this chapter and in Chapter Five—defining outcome and output goals, examining alternative strategies to achieve them, negotiating performance agreements with rowing organizations to produce them, and monitoring and evaluating performance—are not easy to use. Even when organizations are created specifically to steer a public system, their leaders typically don't know how to use these tools, aren't given training to learn them, and don't have enough staff even if they were trained.

Consider New Zealand. "Separated from departmental resources, most Ministers are weak policy makers, despite their nominal control of appropriated funds and their contracting powers," Allen Schick concluded after his in-depth look at its reforms. "Most have only a few aides who assist on Cabinet and Parliamentary work and typically spend little time on departmental matters."

Both Sweden and the U.K. have experienced similar problems. To facilitate better steering, "Many Ministers have advisory boards to assist them with setting targets, to advise on the monitoring of agencies' performance and to act as a link between the Minister and the agency," explains a British government paper on the reforms. "These advisory boards typically consist of a mixture of civil servants, who are familiar with the work carried out by the agency, and outsiders who bring business expertise or knowledge of the market in which the agency operates." In a 1994 survey, agency executives expressed great enthusiasm about the contributions of these boards.

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Still, most departments and advisory boards have lacked an essential element of effective steering: outcome goals. The British government did not create departmental outcome goals until 1998. Before this, the departments knew how to push their uncoupled agencies to become more efficient and effective at what they already did, but few examined whether they were achieving the right outcomes. "They've created the agencies, and they've all done very well in a very narrow sense, to deliver process and service improvements," Ron Oliver told us in 1999. But because the departments told them what to do, not what outcomes to achieve, few had much room to rethink the strategies they used. Some departments even slid back into business as usual, no longer taking very seriously the evaluation of agencies during their five-year reviews or the negotiation of framework documents and annual targets.

The Department of Transport took the negotiations seriously, Oliver says, but resisted any focus on outcome goals, such as reducing the number of highway accidents and deaths. It also focused on the parts, not the whole. "Unless you have a strategy applying to transport as a whole," Oliver points out, "you may miss service improvements, process improvements, and so on." Should people really have to take a driver's test from one agency but receive their license and registration from another, for instance?

> *You may also do something in one agency that works against another agency's objectives. You need a very high-level set of objectives and a vision and strategy. . . . None of that exists, and it became clear a couple of years ago that without it we weren't going to be able to meet our real potential.*

With each agency so focused on its own performance targets, it was difficult to develop new cross-agency strategies. And the department never stepped in to force collaboration between agencies—or even to include it in agency goals.

Frustrated by the lack of strategic leadership from the department, Oliver finally left the agency and civil service in 1998. About that time the new Labor government began to focus on the problem, and the department (now merged into a new Department of the Environment, Transport, and the Regions) launched a review to examine ways to improve the delivery of services by five different transport agencies. It recommended (and the ministers agreed to create) a "strategy board" to "set the direction for the five organizations and drive change across the area."

Meanwhile, the Labor Government negotiated public service agreements (PSAs) with each department specifying departmental outcome and output goals, performance measures, resources, key policy initiatives, and plans to improve productivity. The government promised that its departments would renegotiate their agencies' "objectives and targets" to make sure "that they are better focussed on ensuring that the targets set out in the PSAs are met." If so, this will push the departments to rethink what they want from their agencies. If the elected ministers now hold their top departmental civil servants accountable for achieving the PSA outcome goals (and keep them in their positions longer than the two to three years that is now common), those civil servants should begin to take a more strategic view with the agencies. All of this will require, of course, that the British government get as serious about leadership and accountability at the steering (departmental) level as it has at the rowing (executive agency) level.

As this example demonstrates, to get effective steering someone must be held accountable for thinking strategically about improving outcomes. This is yet another reason why we encourage governments to create distinct steering organizations when they uncouple steering and rowing. Few elected officials are capable of actually evaluating competing strategies and negotiating good performance agreements with rowing agencies. They should delegate that job to steering organizations, fund them sufficiently to purchase the outcomes the elected officials desire, and hold them accountable for doing so effectively. (See Chapter Five for a thorough discussion of how to do all of this.) The elected officials should focus their best energies on the most important steering questions: "What outcomes do we want to deliver for our citizens? How can we best achieve them? And how much are we willing to pay for them?"

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Uncoupling: Other Lessons Learned

1. Clear the decks before uncoupling.

This is simple common sense. In the process of uncoupling large departments, it makes sense to review whether each function still needs to be performed. There is nothing quite as wasteful as working hard to improve an organization that should no longer exist (unless it is necessary to uncouple and restructure a function to raise its value before trying to sell it). We recommend a periodic options review to make these decisions, as outlined in Chapter Six.

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2. If you want real results, combine uncoupling with the Consequences and Control Strategies.

In both the U.K. and New Zealand, uncoupled organizations were given performance targets, consequences, and significant new flexibilities. The act of uncoupling separate functions will spur improvement, but the dramatic results seen in the U.K. and New Zealand come from using all three strategies together. When Canada copied the Next Steps reforms, it failed to provide significant consequences or flexibility to most of its new special operating agencies (SOAs). The results were disappointing—except in SOAs set up as enterprise funds (called revolving funds in Canada) and deprived of their monopolies. Once their customers could go elsewhere, they faced direct consequences.

Parts III & IV

3. Reform your administrative systems to take control away from central agencies and hand it to uncoupled organizations.

Unless you simplify and decentralize your budget, personnel, and procurement systems, uncoupled organizations will not have the flexibility they need to maximize their performance. New Zealand gave its uncoupled organizations virtually full control over their money, people, and purchasing, with very positive results. In contrast, Canada required its SOAs to ask for waivers. Because this

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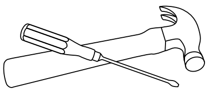
See *Banishing Bureaucracy* pp. II/9-13

led to so little real decentralization of control, a 1994 evaluation of the reform recommended that the Treasury Board create a standard package of flexibilities for all SOAs.

As you reform your administrative systems, you also need to change the behavior of the personnel in any remaining central budget, personnel, and procurement offices. When administrative systems are reformed, those who run them typically keep holding tight to the reins. They do so out of habit and from a sincere belief that managers cannot be trusted with too much flexibility. You need a process to help them adjust to their more limited roles and, in many cases, downsize their staffs.

FLEXIBLE PERFORMANCE FRAMEWORKS



The *Flexible Performance Framework* is a metatool that uncouples steering and rowing, separates rowing functions with clearly different missions and places them in different organizations, then uses written agreements to spell out those organizations' purposes, expected results, performance consequences, and management flexibilities.

The basic model invented by the British and the New Zealanders, which we have labeled a flexible performance framework, has been highly successful in both countries. In the U.K., where most of the 138 executive agencies have significantly improved their performance, few would argue with Parliament's view, expressed in 1994, that it has been "the single most successful Civil Service reform programme of recent decades." The Labor Party certainly didn't; after it took power in 1997, it not only embraced the Next Steps reforms but extended their basic principles to the departments.

The model has been equally powerful in New Zealand, and it has spread to other countries rapidly. In 1989 the Canadian government sent a delegation to London to learn about the Next Steps process, then decided to imitate it. The effort never got the high-level attention it received in the U.K., however, and by 1998 there were only 19 SOAs, covering only a small percentage of the federal civil service. Meanwhile, however, the province of Manitoba had created 16 SOAs, and Quebec was not far behind.

The Netherlands also copied the U.K.'s Next Steps reform, beginning in 1994, and the Australian state of Victoria launched an initiative in 1997. In the U.S., after three years of effort, the Clinton administration finally secured congressional approval of its first PBO in 1998, to run the Education Department's student aid programs.

The Swedes have had uncoupled agencies for 200 years, but they put performance management and organizational empowerment into play only in the 1990s. They have 13 small policy ministries and some 300 fairly independent agencies. Agencies prepare annual performance reports, income statements, balance sheets, and budget and financial analyses. They are subject to in-depth reviews at least every six years, and their "director generals" are hired for six-year terms.

Even local governments have experimented with the model. Richmond, Virginia, negotiated flexible performance agreements with many of its departments in 1998. In Canada, Winnipeg and Toronto have piloted initiatives modeled after SOAs. Other jurisdictions invented the model anew, without ever hearing about the British or New Zealand reforms—simply because it made so much sense. Beginning in 1993, for example, Catawba County in North Carolina created a kind of flexible performance framework for a number of its departments, complete with lump-sum budgets, negotiated outcome and output measures, enhanced authority over personnel positions, and the right to roll over unexpended funds at the end of the fiscal year for departments that met at least 90 percent of their performance targets.

Elements of a Flexible Performance Framework

A flexible performance framework combines at least three strategies: Core, Consequences, and Control. The components of all three are spelled out in what we call a flexible performance agreement (FPA)—a written agreement that articulates the steering organization's expectations, the rowing organization's goals and freedoms, how performance will be reported, and how that data will be used to trigger consequences, both positive and negative. Ideally, FPAs cover three to five years, although we have helped local governments experiment with two-year FPAs. The possible elements of a flexible performance framework can perhaps best be described in terms of the three strategies.

Core Strategy

• ***Uncoupling:*** An FPA separates different functions within a large organization into several different, smaller organizations. Ideally, each smaller organization is given one clear mission—or at most two or three related missions. In a national or state government, four to eight different rowing organizations are typically carved out of a large department. While operating at arm's length, they can be set up as subunits of the department, as in the U.K., or independent organizations, as in New Zealand.

In most local governments, departments are not terribly large, and most steering is done by the elected executive's office or the city or county manager's office. Some cities and counties—such as Richmond and Catawba County—have negotiated flexible performance agreements between the city or county manager and each department. The process of doing this can flush out specific functions that should be uncoupled from the department, because it forces into the open cases in which departments have multiple or conflicting missions. Large departments can always turn around and negotiate FPAs with their divisions, if those divisions have distinct missions.

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• ***Improving Your Aim.*** After uncoupling, the steering side concentrates on developing policy, setting outcome goals, buying services and compliance work from uncoupled agencies, evaluating performance, and using other strategies, such as vouchers and performance contracts with private organizations, to achieve its goals. It gives direction to agencies by negotiating FPAs that define their most important outcome and output goals for the term of the agreement.

pp. II/100-105

• ***Clearing the Decks.*** Every three to six years the status of the organization should be reviewed, as the British do through their options reviews. This periodic options review should include a reappraisal of the strategies the uncoupled agency is using to achieve the outcome goals set by the steering organization—and of whether those strategies and outcome goals are contributing as expected to the government's long-term outcome goals. The following options should be considered: abandoning part or all of the function; privatizing, through an asset sale, part or all of the function; devolving part or all of the function to a lower level of government; shifting to other strategies, such as vouchers or tax incentives; contracting out part or all of the function to another organization; merging part or all of the agency with another agency; restructuring the agency to improve performance; or continuing the agency's current status. If either of the last two options is chosen, the steering organization needs to decide whether the chief executive should be rehired, released, or required to compete for the position in an open job search.

Consequences Strategy

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A flexible performance framework uses several key performance management methods to create real consequences for performance:

• ***Performance targets.*** The FPA should spell out ten or fewer key outcome and output goals for the uncoupled organization. Typically, specific targets and indicators for each of these goals are then negotiated each year. For example, an outcome goal for a police department might be a reduction in the rate of violent crime. Each year a specific percentage reduction would be negotiated, based on both past trends and what the city manager and police chief think is possible in the coming year. (As we explain in Chapter Eleven, the best approach is often to avoid arbitrary numerical targets and simply set a goal of overall improvement.) Ideally, some outcome and output goals will remain stable over the three-to-six-year life of the agreement, to allow comparisons over

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time. But as performance improves and priorities change, specific targets and indicators will change, emphasizing different aspects of performance (quality versus efficiency, for example.)

pp. III/134-7

• ***Performance contracts.*** Although an FPA is signed by an agency's chief executive, it is an agreement about the purpose, performance accountability, and flexibilities of the *entire agency.* It is not a personal performance contract, with the kind of legal standing such documents have. In larger governments, the steering organization typically develops such a personal performance contract, carrying the same length term as the FPA, with the chief executive of the uncoupled agency. In local governments with city or county managers, the FPA is often the only written agreement. The difference is politics. Chief executives of uncoupled agencies should not be fired because a new administration has come into office—a new president, minister, governor, mayor, or county executive. They should be removable for cause or performance, but not for political reasons. If a government consistently violates this principle, it will find it impossible to recruit the quality managerial candidates it needs, and its chief executives will become typical political appointees. Agency executives already have this protection in most city or county manager systems; hence they don't usually need special contracts. In other systems, they need the contract to protect them from political removal.

pp. III/122-7

• ***Performance bonuses.*** The agency director is typically eligible for a financial bonus, based on the organization's performance against its annual targets. Many directors also negotiate the right to institute performance bonuses for some or all of their employees. To create commitment and teamwork among all employees, we recommend including bonuses for as many employees as possible in the FPA. Although local governments with which we have worked have started with 10 percent bonuses for CEOs, to keep the stakes from being too high in the first year, Vice President Gore proposed bonuses of up to 100 percent of salary for chief operating officers of PBOs. In the U.K. bonuses can range up to 20 percent, though most are less than 10 percent.

Though the formula to determine how much of the potential bonus the chief executive gets should rest primarily on objective performance levels, we suggest you also include some element of subjective judgment by the steering organization. This is to compensate for external events, such as particularly bad winters that drive up snow-plowing costs for a public works department, or sharp recessions that hurt a job placement agency's ability to find people jobs.

pp. III/112-3

• ***Periodic performance reviews.*** The agency's and chief executive's performance should be reviewed by the steering organization at least once a year, to assess progress, provide feedback, and stimulate learning from experience. We recommend doing this more than once a year, to maximize learning, although in large governments this is sometimes difficult. Formal reports on performance

should be submitted by the agency annually. After the annual report and review, any performance bonuses should be calculated, and new annual performance targets should be negotiated.

•***Other consequences.*** There are innumerable other consequences that can be included in flexible performance agreements, such as customer redress, increased or decreased flexibilities for the organization, increased or decreased privileges for the chief executive or other employees, and increased or decreased rewards for employees. Although financial consequences are important, "psychic pay" is equally important. Steering organizations should put particular emphasis on publicly recognizing high performers.

pp. IV/125-131

pp. III/112, III/120-121

Control Strategy

• ***Organizational empowerment.*** Flexible performance frameworks produce dramatically better results only if they give uncoupled agencies enough freedom to initiate serious innovation. We recommend negotiating agreements of three to six years, to give uncoupled organizations long enough that they feel free to undertake major efforts to change what they do and how they work. If their budget and expectations keep changing every year, they will feel that it is risky to start a change process that may take several years to bear fruit, because it could easily be disrupted in midstream. To produce fundamental improvement, uncoupled agencies need both flexibility and *time.*

Organizational empowerment should come in two other ways: from systemwide reforms in budget and finance, personnel, and procurement systems, to give all uncoupled agencies significant flexibility; and from additional flexibilities granted to particular agencies in their FPAs. We have found that it is often difficult for managers to define the flexibilities they need. Like fish who don't understand the water in which they swim because it is all they know, they often accept restrictions as simply the way things are. Hence it helps to give them a checklist of possible flexibilities they can use, such as those described in the box on the following pages.

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Designing Flexible Performance Frameworks: Lessons Learned

1. Make sure the initiative has high-level political support.

In New Zealand and the U.K., uncoupling had strong support from the prime minister and other key ministers. Without such support, departments often go through the motions of creating uncoupled agencies but don't fundamentally change they way they deal with them. They don't take the negotiation of FPAs seriously, they don't give agencies significant flexibility, they don't shift from a hierarchical to a contractual relationship, and they don't stop telling agencies what to do and start telling them what results to produce. After a few years, the uncoupled agencies look much like the rest of the department, despite their new trappings. This is precisely what happened to many of Canada's SOAs.

POTENTIAL FLEXIBILITIES FOR UNCOUPLED ORGANIZATIONS

Budget Flexibilities

pp. V/50-54

- Shared savings, in which agencies are allowed to keep part or all of any operating money they do not spend during a fiscal year
- Shared earnings, in which they are allowed to keep part or all of any new funds they earn
- Lump-sum operating budgets, or lump sums for each division or program's operating expenses
- Freedom to move money between accounts or line items without approval from above
- Freedom to borrow a certain amount against next year's appropriation
- Access to an innovation fund, from which the organization can borrow to finance investments that will improve its performance

Personnel Flexibilities

pp. V/54-58

- Simplification of job classification systems—preferably down to a dozen or fewer basic job classifications (clerical, technical, professional, managerial, and so on)
- Use of three to five broad pay bands for each broad job classification
- Power to recruit and hire people on their own, within broad guidelines—and to use commercial firms to help
- Streamlined hiring and firing processes: changes to probationary periods, doing away with some written exams, different methods to rank applicants, streamlined appeals processes for firing, and so on
- Changes in procedures to deal with poor performers, short of firing
- Authority to develop new dispute resolution or grievance procedures for employees
- Changes in compensation: lump-sum payments or special pay rates to recruit or retain talent, incentives to encourage early retirement, team-based pay, skill-based pay, and so on
- Authority to create performance appraisal systems and set rewards (both financial and nonfinancial)
- Authority and funding to award employee performance bonuses

pp. III/122-7

POTENTIAL FLEXIBILITIES FOR UNCOUPLED ORGANIZATIONS Cont.

pp. V/127-131

- Authority to create gainsharing for employees
- Freedom to create nonpermanent positions and to use part-time employees, temporary employees, and commercial temporary help services
- Authority and funding to provide any necessary training for employees, using any training providers

pp. III/82

- Authority to retrain redundant employees and place them in other agencies through a job bank
- Freedom from ceilings or floors on numbers of personnel

pp. V/58-64

Procurement Flexibilities

- Credit cards for managers, for purchases up to a set dollar amount
- Increased authority for managers to purchase off-the-shelf commercial products
- Higher purchase floors before procurement regulations kick in
- Simplification of purchasing rules and processes
- Authority to use simplified processes to deal with protests from vendors
- Freedom to substitute best-value for lowest-cost purchasing
- Authority to prequalify bidders in complex contracting processes
- Authority to use past performance as criteria in selecting suppliers, vendors, and consultants
- Authority to use multiple award contracts and quick, informal competitions between the awardees

Support Service Flexibilities

- More flexible travel and reimbursement rules
- Freedom to use nonpublic office space, leasing arrangements, and property management services

pp. III/53

- Freedom to purchase some support services (such as vehicles, office space, building management, travel services, printing, and maintenance) wherever the agency can get the best deal, combined with control over funding for those support services

pp. IV/143-5

- Authority to negotiate service agreements with support service providers that maintain their monopolies

"Throughout the study," the 1994 evaluation concluded, "respondents stressed the need for political support, yet it has been evident that ministers and other parliamentarians have not been seriously seized with the SOA initiative and influenced its evolution."

2. Choose a unit outside the central administrative agencies (budget, personnel, planning) but close to the executive to run the initiative.

Normally, administrative agencies resist creating true flexible performance frameworks, because they think accountability means tying everyone down with rules and restrictions. If the budget office is leading the reinvention charge, as happened in New Zealand, the FPF team can operate out of that office. But in most situations, because the budget office is an obstacle, it is best to set up an independent unit. To earn the trust of agencies and departments, the reform unit must be perceived as neutral and fair—another reason not to use an administrative agency like a budget office, which is never perceived as neutral. To earn the respect of agencies and departments, the reform unit must have significant power; hence it should be close to the executive (president, prime minister, governor, mayor, county executive, or city manager). In the U.K., Thatcher put the Next Steps Team in her Cabinet Office and staffed it with bright young civil servants seconded from their departments.

Canada's experience demonstrated the pitfalls of relying on a budget office—in this case the Treasury Board Secretariat. Canada's 1994 evaluation recommended designating a high-level champion from outside the Treasury Board Secretariat to take over the initiative. "Many participants felt that the operational responsibilities and role of the Secretariat overwhelmed the more discretionary activities related to the SOA reform initiative," it reported, tactfully. "Some even felt that they conflicted."

In addition to launching the initiative, the reform unit should be responsible for monitoring and evaluating it. Creating flexible performance frameworks is not easy. Results are always uneven: some agencies use their new flexibility and accountability to perform miracles; others make few changes. Some elements of the reform work; others get bogged down. And over time, some organizations inevitably sink back into business as usual, going through the motions required by the new arrangements but not taking them seriously. Hence every government needs to monitor and evaluate its flexible performance frameworks—and intervene every few years to shake things up where they aren't working.

3. Force those doing the steering (departments, ministers, city managers, and so on) to let go of their power to micromanage.

Steering organizations must not keep their uncoupled agencies on too short a leash. The New Zealanders avoided this problem by removing every

function save policymaking and oversight from the policy ministries. But in the U.K., where departments remained sizable, “the dead hand of the parent department” remained heavy, as one agency chief executive put it in a 1993 survey. William Waldegrave, then the minister in charge of government reform, told us in 1994, “The departments are still hankering after micromanagement of the agencies and are still retaining people with skills in micromanagement of the agencies.”

Even after the uncoupling process was complete, in 1998, some departments still held their agencies too close for maximum effectiveness. Too many departmental staffers went along with the structural reforms—because they had no choice—but continued to act much as they had before agencies were uncoupled. In Canada the problem was even worse. We conclude from this experience that New Zealand’s approach is preferable: make the agencies independent organizations whose relationship with their steering organizations is purely a contractual one.

Where this approach is impractical, consider the following potential solutions:

- Use a reform office close to the executive to push the departments to let go.
- Create a council of departmental chief operating officers, like the President’s Management Council in the U.S. government, and use it to keep the pressure on departments to let go.
- Require departments to create clear written statements of the responsibilities of each of their remaining units (particularly budget, personnel, and procurement offices), to help them understand where those responsibilities now end.
- Create a process to help the departments adapt to the new situation by eliminating what is no longer necessary. The U.K. used a round of fundamental expenditure reviews (FERs), through which it examined how the departments should be organized for effective steering and reduced their operating budgets.

4. Express the new relationship in a written agreement that forces the steering organizations to guarantee specific flexibilities and the rowing organizations to commit to delivering specific results.

Written agreements help force issues out into the open. In the U.K., the task of writing the initial framework document made visible many of the problems that had to be dealt with to improve performance. A permanent secretary in the Department of Social Security put it this way, referring to the Resettlement Agency:

Defining its objectives and writing its framework document of responsibilities and its first annual business plan proved a major task, since it brought out starkly the inconsistencies in policies and practices with which it had been operating for many years. If the main objective was to resettle its "customers" back into society, where were the targets or the information on how many had been successfully resettled? What counted as "successful" resettlement? Not returning to one of our resettlement centers within a specified period? For how long?

Written agreements also help expose situations in which the steering side is not allowing agencies the flexibilities it had promised. Agencies can use them to resist when steering organizations trample on their management freedoms. In the same way, steering organizations can use them to demand improvement when agencies fail to meet their written performance targets.

5. Make sure steering organizations provide regular feedback to rowing organizations on their performance.

Rowing organizations will take their performance goals seriously to the extent that their steering organization takes them seriously. If the steering organization does a perfunctory annual review before slightly adjusting the targets, the rowing organization will realize its performance is not terribly important to that organization, and it will relax. But if the steering organization reviews performance quarterly or every six months and takes the process of setting annual targets seriously, the rowing organization is likely to put great effort into improving its performance.

Feedback is also critical for organizational learning. The more often feedback is provided, the more often the rowing organization can learn from it. This is particularly true with feedback that goes beyond a review of the numbers to a discussion of what is behind them. Why are key outcomes not improving, even though the organization is hitting its output targets? Why is customer satisfaction low? Is the organization sacrificing quality to increase efficiency? Is this what the steering organization wants? And which of the targets are most important to the steering organization? The more these conversations take place, the more both sides will learn, and the more performance will align with the steering organization's goals.

6. Give uncoupled organizations budget continuity beyond one year, through biennial or three-year rolling budgets.

If uncoupled organizations are to take advantage of their three-to six-year frameworks to strive for fundamental improvements, they need to know at least the rough outlines of their budget for more than one year. Many governments now use multiyear budget frameworks, which not only give organizations their budget for the current year but also project it for two or three extra years. These projections can be adjusted, but those adjustments should usually be minor.

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Multiyear budget frameworks tend not to work well during times of fiscal crisis, when deficits force repeated budget cuts that defy the out-year projections. Hence we recommend combining them with biennial budgets. The ideal approach might be a biennial budget within a four-year budget framework, coupled with a four-year flexible performance agreement. This would appropriate an agency's budget for two years and project its likely budget for the following two years.

7. Use a mix of output and outcome goals to hold uncoupled organizations accountable.

Both New Zealand and the U.K. hold uncoupled agencies accountable for producing only outputs, not outcomes. As we argue in Chapter Five, a good strategic management system should hold organizations accountable for producing a mix of outputs *and* outcomes.

pp. II/56-59

8. Create accountability to customers through customer boards, customer service standards, customer involvement in setting performance targets, and other customer quality assurance tools.

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Flexible performance frameworks make rowing organizations more accountable vertically, up the chain of command. For compliance organizations, whose customers are usually elected officials (representing citizens), this vertical accountability also means accountability to their customers. But for service organizations it does not. Steering organizations can make their service agencies accountable to their customers, however, by giving those customers power. For example, steering organizations can create customer boards to oversee rowing organizations. They can involve an agency's customers in creating performance targets for the agency. They can require agencies to survey their customers and use the results to create customer service standards. And for agencies that can charge their customers for services, steering organizations can use enterprise management to make the agencies dependent on their customers for their revenues.

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9. Create a process for resolving problems that arise between steering and rowing organizations.

Even with the clearest FPAs, problems may emerge. The steering organization or executive may suddenly decide that they need the agency to do something new that is not in its FPA. Or the agency may take an action that is within its rights but creates an unexpected embarrassment for elected officials, such as closing branch offices in their districts. When problems arise, the steer-

ing and rowing organizations need a process to iron them out. In the U.K., ministers appoint one high-level civil servant within the department to be a liaison with each agency. This person keeps an eye on the agency, and if a problem emerges, he and the agency chief executive know they can contact each other. Another option would be to create a mediation process for differences that cannot be easily worked out.

10. Create a risk management process to deal with serious failures.

In 1995, a cantilevered deck built by New Zealand's Department of Conservation collapsed, killing 14 people. An investigation blamed departmental personnel for constructing it with nails rather than bolts. In the U.K., the Prison Service suffered high-profile escapes in both 1994 and 1995. How do steering organizations minimize the risks of such big, costly mistakes by their rowing organizations? First, they make sure the rowing organizations use risk management techniques: anticipating potential risks and developing procedures to reduce or eliminate them, developing information systems that give them early warnings, purchasing insurance when appropriate, and creating cultures in which identifying problems is encouraged and rewarded. Second, they make sure the rowing organizations have options in place in case problems begin to emerge, such as switching to another service provider.

11. Don't create new reporting requirements without eliminating old ones that are no longer necessary.

When agencies negotiate FPAs, they typically agree to measure performance against up to 10 key outcome and output goals and to report the results quarterly or semiannually. They often agree to provide business plans and annual financial reports as well. Yet most agencies are already suffering under a load of reporting requirements. Consider what the National Performance Review found when it looked at reports required by Congress:

> *On August 31 of each year, the Chief Financial Officers (CFO) Act requires that agencies file a five-year financial plan and a CFO annual report. On September 1, budget exhibits for financial management activities and high-risk areas are due. On November 30, IG reports are expected, along with reports required by the Prompt Payment Act. On January 31, reports under the Federal Civil Penalties Inflation Report Adjustment Act of 1990 come due. On March 31, financial statements are due and on May 1 annual single-audit reports must be filed. On May 31 another round of IG reports are due. At the end of July and December, "high-risk" reports are filed. On August 31, it all begins again. And these are just the major reports!*

Rather than add to that load, we recommend eliminating many current reporting requirements, so agency staff have the time to concentrate on performance reports, business plans, and financial reports. Typically, a large percentage of required reports are little more than fossils of forgotten initiatives. Often, no one even reads them.

12. Take very seriously the challenge of recruiting quality chief executives for the uncoupled organizations.

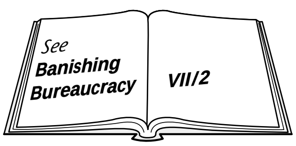
In all three countries we have studied, New Zealand, the U.K., and Canada, the quality of the chief executives appointed to run uncoupled agencies has been a critical success factor. Not surprisingly, strong leaders use their new agency status to push for dramatic improvements. As the Canadian evaluation put it, "People, and particularly the agency head, make the difference."

Pitfalls to Avoid

Some problems emerge so often they can almost be predicted. Among the most common are the following.

1. Lack of clarity about the ground rules.

In both the U.K. and Canada, those running uncoupled agencies received mixed messages about the reform. Part of this had to do with different understandings: reformers expected arm's-length separation and genuine negotiations between departments and agencies, but some departmental leaders expected business as usual. (Because it legally separated its uncoupled agencies, New Zealand did not have this problem—a strong argument in favor of its approach.)



The U.K. also suffered from misunderstandings about whether agencies could later be privatized. When it began creating agencies, the Next Steps Team told their leaders that once their agencies were created, they would be given a number of years to "settle down" before the issue of privatization was raised again. Then, in 1991, John Major's government released "Competing for Quality," a white paper announcing that sale of each agency would be considered during each subsequent three-year review. The new policy also required agencies to "market test" roughly 15 percent of their activities every year, by creating managed competition between agency staff and private bidders. This shift toward privatization infuriated and demoralized many in the agencies, who saw it as a betrayal.

If at all possible, the ground rules governing flexible performance frameworks should be spelled out clearly, fully, and repeatedly as the initiative is launched. In any change process of this magnitude, fear and uncertainty will be widespread. "Will my agency remain public or will it be privatized?" "Will we

have significant independence or will our superiors hold us on a short leash?" "Will our job classifications and pay scales remain the same?" And most important, "Will I profit or suffer from these changes?"

Any confusion or mixed messages will simply heighten the uncertainty, anxiety, and resistance. The media often further muddles things by misunderstanding the government's intentions—equating uncoupling with privatization, for example.

2. *Lack of clarity about accountability for things that go wrong.*

When the deck collapsed in New Zealand, killing 14 people, there was great confusion about who should shoulder the blame. Should it be the minister overseeing the department in question, as it would have been before the reforms? Or was it now the chief executive of that department? Or perhaps the head of the unit that built the deck using nails rather than bolts? The traditional impulse was to find a scapegoat and demand a resignation. But whose?

This kind of confusion is inevitable, unless the government clarifies when it launches flexible performance frameworks who will be held accountable for problems. Commonwealth countries have held on to their constitutional tradition that ministers are accountable for everything that happens in their departments, a tradition that may have made sense when they had a few dozen or a few hundred people working for them, but does not make sense when they oversee tens of thousands of employees. Clearly, an elected minister cannot be expected to know if workers are using nails or bolts—and if he is expected to know these things, he will hold the reins very tightly. We recommend that governments adopt an explicit doctrine that the person who manages a unit is responsible for problems that occur in that unit. Accountability and responsibility should be at the same level, in other words. In a political world, of course, mistakes that have extremely serious consequences are often going to cost an agency executive his or her job. Because this is true, FPAs should spell out as clearly as possible what kinds of mistakes the chief executive will be held responsible for—which risks he or she cannot delegate.

We are not suggesting that you include long lists of potential mistakes for which you will hold the chief executive responsible. An FPA is not a contract, and the last thing you want to do is involve lawyers in the negotiations. But if you know in advance that certain events would have serious consequences for the chief executive—such as a jail break, or the death of a client, or a major case of embezzlement—it is best to make that clear.

3. *Loss of the collective interest.*

When flexible performance frameworks are effective, the uncoupled agencies become almost obsessively focused on meeting their goals. As a consequence, they have less time and energy for collaboration with other organizations around goals that are not in their FPAs. If governments do not counteract this tendency, they lose something valuable: the willing collaboration of all managers in solving problems beyond their own organization's turf. By heightening vertical accountability for results, in other words, flexible performance frameworks can lessen horizontal cooperation between agencies.

The British and New Zealanders talk about this challenge as one of protecting the government's interests as an "owner" of uncoupled agencies, not just as a purchaser of their services. Its ownership interests include collaboration between agencies to meet common challenges; contributions to discussions about policy (for example, a job training agency's contribution to government-wide discussions about welfare reform); and maintenance of the long-term value of government assets, including buildings, equipment, and people. By negotiating only for the best service or compliance work at the lowest possible price, governments risk sacrificing these interests.

New Zealand has confronted this problem directly. Ministers now expect that in negotiating purchase and performance agreements, chief executives will identify for them the potential impact of different options on the government's ownership interests, such as the quality of the workforce or the maintenance of infrastructure assets. They also require chief executives to develop one or more key result areas (program goals) concerned with ownership interests.

This is one good solution: put at least one specific goal related to ownership interests in the FPA. If you want collaboration, make it a performance target. For example, the city manager of Hartford, Connecticut, put a goal of collaboration with selected other departments into each FPA, with performance to be measured by a survey of those other department heads. Other reinventors have included goals related to staff training, to make sure the uncoupled organization maintained a skilled workforce.

A second option is to put one or two government-wide policy outcome goals into each FPA. When Robert Bobb was city manager of Richmond, Virginia, he announced that every department head's new FPA would include a goal of reducing the city's crime rate. He wanted every department to work together to reduce crime.

A third option is to make sure that the outcome goals put into FPAs are those that will contribute to a jurisdiction's government-wide outcome goals. For example, if a state decides that reducing teen pregnancy and increasing the high school graduation rate are statewide outcome goals (as Oregon did), the governor's office could negotiate an FPA with the welfare agency that included the goals of reducing the teen pregnancy rate and increasing the high school graduation rate for teenagers whose families were on welfare.

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These three options are not mutually exclusive, of course. Indeed, we urge you to use all three. In addition, we suggest that a central management agency periodically review whether departments are maintaining their ownership interests, as New Zealand's State Services Commission does.

4. The Ivory Tower Syndrome.

When rowing is uncoupled from steering, policymakers sometimes lose touch with those working where the rubber actually meets the road. Those who know the most about service delivery or compliance work are no longer involved in policymaking discussions. (In many organizations, of course, they never were.) This problem, which has surfaced in New Zealand, the U.K., and Sweden, can be extremely serious.

One useful remedy is to rotate people between policy organizations and operational agencies. Another is to require that uncoupled agencies play a role in the policy development process. In the U.K., for example, some agency chief executives have specific roles in the formulation of departmental policy. "We had an agreement in our framework document that neither party could put a policy submission up without consulting the other, and the other party could put a counterproposal up," Ron Oliver explains. "This forced us to reach agreement before submission. It forced us to try to find solutions before we took policy recommendations to the politicians."

A third remedy is to give uncoupled agencies a role in evaluating policymaking officials' performance—so those officials will realize it is in their self-interest to reach out to agencies as they do policy work. Again, we suggest using all three remedies, because this problem is so common.

5. Lack of shared information in a balkanized system.

"One of the risks of splitting up agencies is that each one builds their own information collection system," explain New Zealanders Judith Johnson, Katrina Casey, and Tony Crewdson in a paper on interagency cooperation and information management. The obvious solution, they suggest, is to build information systems that cross agency lines. In a world of rapid change, which requires different organizations to work together on a myriad of shifting problems, this becomes an absolute necessity. Information must flow easily throughout a 21st-century government if its various organizations are going to be able to collaborate effectively. We have seen governments of all shapes and sizes struggling with this problem. To provide just one example, local police departments, state police departments, the FBI, the various court systems, juvenile justice systems, prison systems, and parole programs are struggling to build systems that help information on accused or convicted criminals flow between them. Johnson, Casey, and Crewdson provide one case study of such a cross-agency information system, in the criminal justice sector in New Zealand.

Tips on Negotiating Flexible Performance Agreements

Negotiating an FPA is a new experience for most people in government. We have found that some approach it with a bureaucratic mind-set—as an exercise in which the boss tells the manager what he or she wants. They tend to spell out activities they want performed, rather than results they want produced. And they have trouble even identifying flexibilities that might help the manager. Hence without some guidance, department heads, mayors, city or county managers, and their deputies can easily turn FPAs into one more exercise in top-down micromanagement.

We have also found that everyone underestimates how long it takes to negotiate an FPA. Done correctly, an FPA raises the most profound questions one can raise about an organization: What is its core purpose? What strategies should it use to achieve that purpose? What outcomes and outputs is it most important for the organization to produce? How can it measure those outcomes and outputs? What level of performance is acceptable? What flexibilities does it need to be effective? And what consequences should management face for their performance? To think that these issues can all be discussed and resolved in a month or two is usually a fantasy, particularly the first time around.

We suggest the following rules of thumb in negotiating FPAs.

Make sure those negotiating FPAs from the steering end buy in to the basic idea. Sometimes executives delegate the negotiation to deputies who don't quite understand or believe in the concept. In our experience, such individuals can quickly turn FPAs into instruments of increased hierarchical control rather than increased clarity, accountability, and flexibility.

Make sure the process is a true negotiation, with plenty of room for give-and-take. Instinctively, many people accustomed to working in a bureaucracy approach the negotiation of an FPA as an occasion for the boss to tell the agency head what's what. When the two sides disagree about performance targets, both sides expect the boss to prevail. This attitude undermines the purpose of a flexible performance framework. If agency managers feel FPAs have been jammed down their throats, they will not buy in to the goal of dramatic improvement. Some will go through the motions and try their best to fudge the performance data—or better yet, make sure it's never collected.

Others will look for another job. But few will dedicate themselves to profound improvement.

When the two sides disagree, it is important for the agency head to feel free to push back as hard as necessary to get a fair agreement. It is up to the executive negotiating the agreement to make sure all agency heads understand and believe they are expected to push back—and that there will be no negative consequences if they do.

A neutral referee can be useful. One of the best ways to ensure that the negotiation is a two-way street is to have a neutral referee who can help both sides understand the ground rules, tell them when they are out of bounds, and mediate when they cannot agree. This is another reason you need a respected, neutral office to drive the uncoupling process, like the Next Steps Team in the U.K.

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Coaches for both sides of the negotiation can also be useful. Particularly the first time people negotiate an FPA, they can benefit enormously from having coaches, who can walk them through the process, help them with first drafts, and help them decide what to push for in negotiations. Either internal or external consultants can play this role.

Executives (the steering side) should indicate what outcomes, strategies, and outputs are most important to them at the beginning of the negotiation process. If they don't do this, some agency heads will prepare draft FPAs that bear little resemblance to what the executive wants. When the executive then says, "I'm not interested in much of what you have prepared; here's what I want," it can quickly feel like another top-down exercise. But if the executive communicates the core of what he or she wants in an FPA up front—and gives the agency head a chance to discuss it—such misunderstandings can be avoided.

Don't overwhelm the agency with too many performance targets; keep the number under 10. FPAs are not meant to list everything an agency must do; they are meant to pinpoint the most important results it should achieve. If you give agency managers too many priorities, they will be forced to spread themselves so thin it will be hard to achieve significant improvement in any area. They may also feel that the entire exercise is simply one more opportunity for their superiors to harass them.

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A British government review of best practices in executive agencies recommended setting only four to seven performance targets per year. Given that it also said, "Target packages should reflect cost, quality, time and output measures," each performance target might have more than one indicator. But we agree wholeheartedly with the basic principle: "Targets should be sufficiently few in number to ensure the right degree of focus from managers."

Don't make the stakes too high in the first year or two if the agency has no performance track record to go by. If an agency is new or has no

real track record, it is difficult to tell what level of performance it can achieve. You can either pick targets out of the air during the first year or simply use the first year to establish a baseline from which to set targets in the future. (We normally recommend the latter.) Either way, it doesn't make sense to create high stakes for the agency manager—such as large performance bonuses or major penalties—during that first year. If you do, agency managers may feel the process is unfair, and those who do poorly may resent those who did well, concluding that favoritism was at play.

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Don't be overly prescriptive in the FPA about how work should be done. For those accustomed to working in bureaucracies, the instinct is usually to tell managers what to do. FPAs are meant to break that pattern: to tell managers what results to produce while giving them the flexibility to find or invent the best methods to produce them.

Specify in the FPA where the executive or department head can intervene and where he or she cannot. After signing an FPA, agency directors should expect to be free from micromanagement. Yet because governments operate in a political world, there will come a time when the executive needs to overrule an agency head's decision or intervene to ask him or her to do something not in the FPA.

To avoid bad feelings, it is wise to be as explicit as possible in the FPA about this. To the degree that he or she can foresee such actions, the executive should spell out the situations in which he or she reserves the right to overrule an agency head's decision or otherwise intervene. As Price Waterhouse advised new Labor Party ministers in the U.K., they should try to distinguish "the many situations about which you need to be informed from the few circumstances in which you need to intervene."

Assume that the negotiation process will require a minimum of two drafts. We suggest roughly the following approach:

- The executive or department head tells the agency manager what outcomes and outputs are most important to produce, providing some opportunity for discussion, clarification, and modification.
- Using a general format provided for all FPAs (see the accompanying example), and working with a coach, the agency head prepares a first draft and submits it.
- The executive and agency head meet, with a neutral referee (and coaches if desired), to discuss the draft. The executive suggests changes, and after a discussion, presents them (as shaped by that discussion) in written form.
- Again working with a coach, the agency head prepares a second draft.

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- The executive and agency head meet again to discuss the second draft and try to reach a final agreement. If they are successful, the referee prepares the final draft.
- If they cannot reach a final agreement, the referee mediates a final meeting, pushes them to responsible compromises, and if they still cannot agree on an item, imposes a solution.

Set a deadline for first drafts and a deadline for completion of the final draft. This process is difficult enough for most people that it can drag on forever. Often it is easier for both sides to let time pass than to do the hard work necessary to resolve tough issues. Deadlines are indispensable.

When the negotiations pinpoint policies that need to be changed to allow more flexibility, make those changes. If you pay attention, the agency heads' requests for flexibility will show you where your budget, personnel, procurement, and other rules need to be changed. This is one of the side benefits of the process. In most governments, changing these rules is difficult. If you do nothing to reform them, however, agency directors will quickly conclude that the promised flexibility—their biggest upside in the deal—is a sham. Sometimes the executive won't be able to change the rule in time to grant the flexibility outlined in the FPA, but he or she should at least promise, in writing, to pursue the necessary reforms.

RESOURCES ON FLEXIBLE PERFORMANCE FRAMEWORKS

Next Steps Team. *The Strategic Management of Agencies: Models for Management.* London: Her Majesty's Stationery Office, September 1995. A look at how departments can best steer executive agencies, including very specific recommendations on best and worst practices.

Performance-Based Organizations. Web page: www.npr.gov/initiati/21cent/index.html. A description of the U.S. government's proposed flexible performance frameworks, along with model legislation, sample position descriptions for PBO chief operating officers, and a list of potential flexibilities in personnel, procurement, and administrative services.

Allen Schick. *Modern Budgeting.* Paris: Organization for Economic Cooperation and Development, 1998. An excellent book on budget and finance system reform in developed countries. Includes material on uncoupled agencies in Sweden, New Zealand, and the U.K.

A MODEL FLEXIBLE PERFORMANCE AGREEMENT

I. The Organization's "Statement of Purpose" (Mission Statement)

II. The Organization's Basic Responsibilities

III. Resources

A. The budget to be provided, preferably over the term of the FPA.
B. Anything related to other resources, such as the workforce or the capital budget.
C. The financial accounting, auditing, and reporting system to be used.

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IV. Expected Results

A. Half a dozen key outcome and output goals for the organization.
B. One or two citywide, countywide, statewide, or nationwide outcome goals to which the agency is expected to contribute.
C. The agency's expected role in providing policy advice to the executive, and how its performance in doing so will be measured.
D. Individual objectives for the agency director, such as leadership training or development of increased skills in a particular area.
E. How performance will be measured and reported.
F. How performance measurement will be audited to make sure it is accurate and fair.

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V. Flexibilities

A. Budget flexibilities to be allowed.
B. Personnel flexibilities to be allowed.
C. Procurement flexibilities to be allowed.
D. Support service flexibilities to be allowed.
E. Other flexibilities.

VI. Special Conditions

This section can be used by either side to indicate conditions that must be met for it to fulfill what the FPA requires. For example, the agency director might say that unless the purchasing rules are changed in a particular way, the agency will not be held accountable for meeting one of its efficiency targets. The steering organization might say that unless the agency achieves a certain performance level or uses an approach such as managed competition, personnel ceilings will be reestablished.

A MODEL FLEXIBLE PERFORMANCE AGREEMENT - cont.

VII. Expectations of the Steering Executive
This is where the executive can lay out his or her expectations of the agency director beyond results to be produced. For example: "When you bring me a problem, it is your responsibility to bring with it options for solutions and your recommended solution." Or: "When problems occur, I want to hear about it first." Or: "I will hold you personally responsible for the death of a client."

VIII. Responsibilities of the Steering Executive

A. How the executive will play an oversight role: for example, who the executive will delegate oversight duties to, if anyone; how often that person will meet with the agency director to review performance; and how available he or she will be to the agency director for meetings on other issues.

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B. Definition of areas in which the executive can intervene or override the agency director and areas where he or she cannot do so.

IX. Consequences

A. Financial consequences for performance, such as bonuses. Typically this section would define the formula used to calculate a performance bonus for the agency director and perhaps other agency employees. For example: if 80 percent of performance targets are met, the bonus will be 10 percent of salary; if 90 percent are met, the bonus will be 20 percent of salary.

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B. Redress to customers. If some of the performance targets are in the form of customer service standards, the FPA could spell out how the agency will make it up to customers if and when it fails to meet those standards.

C. Other consequences. These might be positive or negative or both. They could include increased or decreased flexibilities, increased or decreased privileges (such as use of a car, or extra professional development time), or even increased or decreased investments in training, technology, or office space.

X. Term of the Agreement
Ideally, the term of the FPA will be three to six years, though performance targets may be adjusted more often than that.

XI. Amendment Procedures
Typical FPAs state that they can be amended by mutual written agreement of the executive and agency director at any time.

SAMPLE FLEXIBLE PERFORMANCE AGREEMENT FOR A POLICE DEPARTMENT

I. Mission Statement
Improve public safety through collaboration, problem solving, and equitable and fair enforcement of the law.

II. The Organization's Basic Responsibilities
   A. Prevent crime through community policing.
   B. Investigate crimes and apprehend criminals.
   C. Work with prosecutors and the courts to achieve convictions.

III. Resources
The budget over the term of this agreement will be $31.2 million in Year One, $32 million in Year Two, and $32.4 million in Year Three.

IV. Expected Results
   A. Departmental Outcome and Output Goals
      1. Reduce the rate of violent crime: murder, rape, robbery, aggravated assault, and domestic assault.
      2. Increase the number of firearms confiscated by 10 percent a year.
      3. Improve the clearance rate of homicides to 80 percent within eight months of the crime.
      4. Achieve a positive customer satisfaction rating from 70 percent of citizens surveyed.
      5. Respond to all action line requests and complaints within five business days.
      6. Achieve at least a "satisfactory" rating by neighborhood organizations on a survey of their members' satisfaction with departmental responsiveness to their concerns.
   B. Citywide Outcome Goals
      1. Increase the percentage of positive ratings on a citywide citizen satisfaction survey each year.
   C. Individual Objectives
      1. Participate in at least one week (five days) of leadership development training per year.
   D. Performance Measurement, Reporting, and Auditing
      1. Performance on these goals will be measured by the measurement unit within the police department and reported to the city manager quarterly.
      2. The city auditor's office will audit the measurement system through periodic spot checks.

SAMPLE FLEXIBLE PERFORMANCE AGREEMENT FOR A POLICE DEPARTMENT - cont.

V. Flexibilities

A. Budget flexibilities. The Police Chief is free to transfer funds within the department as needed, without permission, with the exception of spending on hiring additional personnel.

B. Personnel flexibilities. Authority is granted to provide gainsharing and performance bonuses to employees and to hire civilian (nonpolice) personnel for clerical positions.

C. Procurement flexibilities. Authority is granted to make purchasing decisions below $2,000 free of normal procurement processes.

D. Support service flexibilities. Authority is granted to have departmental vehicles serviced at any repair shop designated by the police chief.

VI. Special Conditions

This agreement assumes that no major catastrophe, such as a civil disturbance, a gang war, or a natural disaster, occurs. Should such an event occur, this agreement will be renegotiated.

VII. Expectations of the City Manager

A. I expect you to anticipate problems and opportunities and act on them, rather than waiting to be told what to do by the city manager's office.

B. I expect deadlines set by the city manager's office to be met. If you cannot meet a deadline, I expect an explanation in advance.

C. I expect all police officers to receive diversity training during their first year on the job.

VIII. Responsibilities of the City Manager

A. The police chief will report to Deputy City Manager Ford, who will meet with the police chief quarterly to review agency performance.

B. In the event of a civil disturbance in response to police behavior, the city manager and her deputy reserve the right to intervene and override decisions of the police chief.

IX. Consequences

A. Financial consequences. If all performance goals are met, the police chief will receive a bonus of 20 percent of his salary; if eight or more are met, including Goal 1, the bonus will be 15 percent; if eight or more are met, not including Goal 1, the bonus will be 10 percent; if seven are met, the bonus will be 5 percent.

B. Other consequences. If the police department fails to meet five or more of the performance goals, the city manager will impose one of the following consequences:

SAMPLE FLEXIBLE PERFORMANCE AGREEMENT FOR A POLICE DEPARTMENT - cont.

1. A monthly meeting to review performance.
2. Limits on travel until performance improves.
3. Probation for a specific period of time.

X. Term of the Agreement
This agreement will be valid for fiscal years 2000, 2001, and 2002. Specific performance targets will be renegotiated at the beginning of each fiscal year.

XI. Amendment Procedures
This agreement may be amended at any time through mutual agreement of the city manager and the police chief.

Questions People Ask About Uncoupling

Q: Are there any situations in which steering and rowing should not be uncoupled?

This is a subject of significant debate in the U.K. and New Zealand. The New Zealanders have generally answered no, while the British have answered yes. We lean toward New Zealand's position, but not quite all the way. In our view, *almost* any function can benefit from the separation of steering and rowing and the creation of a contractual, arm's-length relationship. There are a few situations, however, in which either the control or the consequences strategy is impractical, so uncoupling may not be wise.

When an activity is extremely sensitive, requires a great deal of coordination, or involves great risk, policymakers may want to hold it very close. Examples might include defense, intelligence activities, and diplomacy. New Zealand tried uncoupling defense by creating a civilian defense policy ministry separate from the military. According to a number of respected academics, this led to problems. They report that the uncoupled model, "while retained in statute, is all but a fiction in practice."

When it is impossible to specify or measure outputs with any clarity, it becomes impossible to create consequences for performance. This might be the case with diplomacy, for example. Measuring the performance of diplomats appears to be almost entirely subjective. Peter Drucker's warning about federal decentralization in large corporations applies in government as well:

> *Indeed, wherever a federal organization gets in trouble...the reason is always that the measurements at the disposal of the center are not good enough, so that personal supervision has to be substituted....To be able to give autonomy one must have confidence. And this requires controls that*

make opinions unnecessary. To be able to manage by objectives one must know whether goals are being reached or not; and this requires clear and reliable measurements.

Q: Won't uncoupling create many small agencies, all of which have to have personnel functions, procurement functions, and the like? Won't this duplication be inefficient? Isn't it more efficient to use larger organizations that can achieve economies of scale?

In a word, no. As General Creech argues, the key to high performance is to think big but organize small. Large organizations have many diseconomies of scale, because they tend to remove so many decisions from those who know the most about the issues in question. As for duplication of internal support functions like personnel and procurement, uncoupling allows for different policies in different organizations, which creates more efficiency, not less. And by using internal enterprise management, which we discuss in chapter 5, governments can allow organizations to buy many internal support services wherever they can get the best deal, rather than producing them in-house.

Q: Can radical reinvention as practiced in New Zealand work in smaller, local governments?

Yes. In fact New Zealand's Labor Party pushed through legislation in 1989 that completely restructured local government, shrinking the number of local and regional jurisdictions from more than 700 to 86 and imposing the same principles on them that Labor had imposed on the national bureaucracy. Policy, service-delivery, and compliance functions were separated, and elected councils now have direct authority only over policy. The reforms handed operational authority to chief executives, hired by councils on five-year performance contracts. All other local or regional employees work for the chief executive, not the council.

Councils must now prepare annual plans that specify their objectives, desired outcomes and outputs, performance targets and indicators, resources, and costs. In addition, they have to prepare general plans for the following two years. At the end of each year they must publish a performance report, showing how they did compared with their objectives and targets.

The reforms encouraged corporatization of commercial functions, many of which have been organized as local authority trading enterprises, the local equivalent of SOEs, or "business units," the equivalent of enterprise funds. These entities are encouraged to bid on work not just in their jurisdictions but in others, and some have been privatized.

Local authorities are not required to competitively bid out services, as in the U.K., but they *are* required to formally examine the advantages and disadvantages of different service-delivery options, public and private. This has led to a dramatic expansion of contracting: by 1994, the percentage of local services delivered by external providers had increased from 22 to 48 percent, according to a national government survey.

The reforms applied the new financial management and human resources frameworks to local government as well. They now use accrual accounting and general accepted accounting practices, as well as performance contracts for all salaried employees. Hourly employees can choose between negotiating their own performance agreements and designating a bargaining organization.

Did these reforms work? Apparently so. In 1993, after a worldwide search, Germany's Bertelsmann Foundation named Christchurch, New Zealand, one of the two best-managed cities—along with Phoenix, Arizona—in the world.

Notes

All quotations that are not attributed in the text or in these endnotes are from interviews with the authors or their associates. Only in cases where there might be some confusion about the source of a quotation have we indicated in a note that it came from an interview.

Chapter Seven

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