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Governance of Public Agencies in Latvia

by

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INTRODUCTION

In line with the growing number of state functions and emerging demand for qualitative public services the state has to seek possibilities to work more efficiently, which means to increase the number of services delivered and their quality within the limits of existing budget. To carry out the functions and to render the services, which are crucial to the state and citizens and which cannot be provided by the private sector or local governments or their execution cannot be entrusted to them, the state has to look for other organisational forms able to ensure achievement of results in the most efficient way².

The government of Latvia in the time period starting with the year 1996 has supported transfer of execution of state administration functions to particular institutions – non-profit state joint stock companies and limited liability companies (non-profit companies). The process of establishment of such type of institutions differed from the experience in other countries as the laws governing business activity in the private sector were used for establishment and operations of these institutions. Operational and management model of non-profit companies is built in compliance with the model used in business activity which is set in the number of laws governing activities of private sector enterprises – law “On Business Activity”, “On Joint Stock Companies”, “On Limited Liability Companies”, “On Non-Profit Organisation”. It does not provide for transparency, accountability for the results achieved and effective use of public resources that is necessary for public institutions. The status similar to the business entity assigned the state institutions the rights without any reason to disregard the law “On Openness of Information” and exempted them from the requirements to observe the procedures of public procurement in business activities.

Thus such issues being of very high importance to the public sector as responsibility and accountability mechanisms, justification of financial operations, the role of the ministry in controlling the company and liability of the ministry for legitimate activities of the company and efficiency of its operations are not regulated in accordance with traditions and principles existing in the public sector.

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² Concept paper on Public Agencies, accepted by the government on 8 February 2000

After becoming a non-profit company the results delivered by the institution, if we compare them with the results of the same institution when it was in the status of public administration institution, very often did not change significantly. It was quite rare case when due to the new regulation of activities higher rate of productivity was achieved and the quality of public services improved significantly. However, more and more often the activities of the institutions attracted the attention of the government and the society in connection with its illegal operations or reported cases of corruption.

The reasons to worry about were the fact that these institutions enjoyed too much freedom and their activities were not always in line with the set government policy objectives. There was a gap of responsibility and accountability between the delegated competence and trust on the one hand and the way this trust was exploited on the other hand.

On the basis of the above mentioned, the following problems in the operation of non-profit companies were identified:

- Corruption
- Absence of clear policy direction
- Absences of a set of operational performance indicators
- Poor or non-existent non-financial reporting
- Lack of agency steering by under resourced ministries
- Confusion or ambiguities in lines of agency accountability to ministries
- Lack of internal audit

The growing number of such institutions without any legal base, especially in the service delivery areas, caused uneasiness also in international organisations. The World Bank, The International Monetary Fund and the European Commissions expressed its concerns that the government, which is accountable for lawfulness and impartiality of its structures, loses its ability to influence and control the way the state budget resources are administered and public services delivered.

These institutions also required the government of Latvia to establish a legal base for public agencies – the form which will protect the state and the society from illegitimacy, ineffective use of resources and limited ability of the government to manage public sector³.

³ Requirements to establish a legal base and provisions on reorganisation process foreseen in it was included also in the World Bank Structural Adjustment Loan conditions (Matrix of policy reform program) and Economic Policy Memorandum of the International Monetary Fund

1. ESTABLISHING PUBLIC AGENCIES AS A SOLUTION

1.1. The concept of public agency

To carry out the functions and to render the services, which are crucial to the state and citizens and which cannot be provided by the private sector or local governments or their execution cannot be entrusted to them and:

- to improve efficiency of public spending;
- to improve the quality of services provided by public institutions;
- ensure openness and accountability for the achieved results and use of public resources and
- establish preconditions for Latvia to successfully implement the tasks set by the European Commission and other international institutions

the state has to look for other organisational forms able to ensure achievement of results in the most efficient and professional way.

To solve the problem concerning state non-profit companies, a Concept paper on Public Agencies was prepared and approved in the Cabinet of Ministers (the government). The paper was prepared taking into account foreign experience and findings of research. On the basis of the concept paper Public Agency Law was prepared, which came into force 25 April 2001. According to the law **public agencies** are public bodies under the supervision of a ministries operating within the framework of objectives set by the ministries and reporting on their operations to the ministry and the society. Agencies may be entrusted with the following public functions:

- 1) to deliver services to state bodies and institutions of local authorities;
- 2) to deliver public services⁴ to citizens (permanent residents) and legal entities;
- 3) to manage and implement state, municipal and international projects and programs.

The law or regulations of the Cabinet of Ministers assigns an agency with certain public functions to be performed in accordance with the management agreement signed by the supervising minister and by the director of the state agency⁵.

Also the Commercial Law, which will come into force 1 January 2004 and will substitute law "On Business Activity", "On Joint Stock Companies", "On Limited Liability Companies", which served as a legal basis for state non-profit company operations. The Commercial Law does not provide such a form of activity as state non-profit company.

According to the overall concept the agency bases its activities on the *quid pro quo* principle - "more freedom for more accountability". It means that giving the head of the agency more freedom, the ministry

⁴ In terms of Public Agency Law public services delivery is offering of tangible or intangible benefits to citizens (residents) and legal entities in the fields of culture, education, health care, social welfare, environmental protection, etc., in order to meet public demand for these services as provided by the law or regulations of the Cabinet of Ministers.

⁵ Public Agency Law (2001), Article 4

asks for better results. According to the Public Agency Law the public agency is also characterised by the following:

- it is established, reorganised and liquidated by the Cabinet of Ministers proceeding from the law or on its own initiative;
- it is supervised by the minister;
- middle term strategic planning of results and resources;
- performance management agreement (the minister – director of the agency);
- managerial accountability principles;
- responsible official nominated by the minister;
- accountability and reporting mechanisms.

Using public agencies is not new, it is a tried and trusted method. But to be successful needs a sustained effort over a period of years. Establishing agencies, the government implements a progressive aim: separates policy implementation activities from policy implementation, which is the responsibility of the ministry. It is planned to implement it not only in Latvia – it exists in many western countries (e.g., United Kingdom, Australia, Sweden, Denmark) for decades.

1.2. Foreign experience

When considering the creation of new specific entity, perhaps the most basic question to be asked is “why use the agency form of organisation?”. No general answer is attempted here. Many European Union and Organisation for Economic Co-operation and Development (OECD) countries – Denmark, United Kingdom, Australia and other – established a new institutional form – agencies in the end of 1980ies and beginning of 1990ies. There are many of the excellent motives for which countries establish agencies: they range from commercial effectiveness, to insulating sensitive decisions from politics, to increasing economy and efficiency, to permitting experts and affected citizens to be drawn into decision making⁶. However, the experience has shown also bad examples of using public agencies (giving them too much powers) that resulted in inefficient use of financial resources, presence of bias – favouritism rather than merit to determine of benefits.

The agencies carry out state functions using management methods developed in the private sector. Success in establishing and operation of agencies is characterised by ensuring a number of certain elements:

- delegation of competency⁷ to carry out a certain state function;
- clearly defined state policy in the area the agency operates;
- resources are provided to achieve targets;
- use of performance management agreement as a management tool;
- medium-term strategy that is built on state policy and defines main directions for operation for 3-5 years;

⁶ Financial Management and Control of Public Agencies (12-Apr-2001), SIGMA Papers No. 32: 23

⁷ By competency we mean rights and responsibilities

- clearly defined performance targets (qualitative, quantitative, efficiency indicators);
- freedom of agency director to manage daily operations;
- clear accountability and reporting mechanism, system to evaluate the performance of the agency;
- motivation and stimulation system that is related to the performance.

Using the advantages given by the above-mentioned management elements, public institutions are motivated to use resources in the most rational way, take care of improvement of service quality as one of the conditions in the performance agreement, and better plan investments in the long-term period.

1.3. Why are public agencies good for Latvia?

The driving forces for most of governments have been the need to reduce spending, on the one hand, while, on the other hand, strengthening their own legitimacy by improving the quality and responsiveness of public service delivery⁸.

So, how the state and the society expects to benefit from public agencies? The first part of the answer is - with the improvement of public service quality the satisfaction with the performance of the public agency, and the public administration, will improve. It can be achieved with the following means:

- A clearly defined area of business – objectives;
- A downward and outward focus on delivery of services within an agreed framework of accountability – targets and performance management agreement;
- Financial and personnel flexibilities to get the job done (agency employees are not civil servants).

Secondly, the public expenditure management will be improved as:

- agency director has personal responsibility and accountability for operational decisions and reports to the minister;
- agency is clearly part of government and subject to national standards of accounting and reporting - audit by the State Audit Office and overseen by the Ministry of Finance;
- agency publishes annual report and accounts including a review of performance against targets.

In particular, compared to Ministries agencies are better focused on service delivery, better able to develop and sustain service delivery and management skills and are better focused on results (outcomes) and the resources needed to achieve them. Unlike ministries they are less prone to short-term political priorities squeezing out long-term planning.

As agencies develop their success is credited to the following characteristics:

- a clarity and focus on specified tasks
- a culture of delivery
- tailor-made structures and systems designed to get he job done
- innovative thinking and action

⁸ Financial Management and Control of Public Agencies (12-Apr-2001), SIGMA Papers No. 32: 24

- risk management
- problems solved, not hidden.

2. GOVERNANCE OF PUBLIC AGENCIES

2.1. Principles of good governance for public agencies

How can we define good governance? Corporate Governance is presented as the concepts, theories and practices relevant to boards and their directors and the relationships between boards and shareholders, top management, regulators and auditors. Ultimately, of course, corporate governance is about the exercise of power over the modern organisation. In the public sector, the process of exercising power means:

- Impartiality, integrity and objectivity. These clearly support the notions of reliability and predictability of public administration. Professional integrity relies upon the notions of impartiality and professional independence. Impartiality refers to the absence of bias. Within public administration bias means having an inclination in favour of particular outcome in assessing a given situation, causing as a consequence an unjustified or unfair detriment to the general interest or to the right of the interested parties;
- Value for money - has the state's money been spent wisely, has economy, effectiveness and efficiency been achieved. Efficiency is a characteristic managerial value consisting in essence of maintaining a good ratio between resources employed and results attained. A related value of effectiveness basically consists of ensuring that the performance of public administration is successful in achieving the goals and solving the public problems set for it by law and government;
- Accountability. According to the European principles of public administration it means that person/ organisation must explain and justify its actions. Accountability is essential to ensure values such as efficiency, effectiveness, reliability, and predictability of public administration;
- Openness. It suggests that the administration is available for outside scrutiny, it is a necessary instrument to ensure accountability⁹. Principle of openness suggests that agencies must keep society, Ministers, responsible officials etc. informed about their actions.

Thus, good governance for public agencies can be characterised by the following principles:

- Trust and confidence;
- Two way dialogue and understanding ensuring no surprises
- Shared strategic vision
- Meaningful, stretching but achievable targets
- Risk assessment and management
- Effective performance monitoring and review.

⁹ European Principles of Public Administration (19-Nov-1999), SIGMA paper No. 27: 11

2.2. The governance structure

The governance structure of public agencies set in Public Agency Law is based on the principles of good governance and implementation of the principles is ensured by the following key players – minister, responsible official in the ministry and the head of the agency¹⁰.

The Minister

The minister is ultimately responsible and accountable to the parliament and the society for policy, strategy and performance of the agency. To supervise the state agency the minister approves the management framework of the agency - the medium term performance and development strategy, annual performance plan and annual budget as well as signs the management agreement with the director of the agency. Minister has the right to request and receive information on the operation of the state agency that enables him to exercise his duties.

To ensure daily supervision of the agency, the minister appoint one of the civil servants of the ministry as the responsible official for the supervision of the performance of the agency (hereinafter - responsible official) and sets up an advisory board, if it is stipulated by the statute of the state agency and approve its regulations.

The minister has no rights to issue direct orders concerning the operations of the state agency, except in cases that refer to planning and evaluation the performance of the state agency.

The minister nominates, dismisses and imposes disciplinary sanctions on the director of the state agency, according to the legal acts regulating labour relations, and has rights to revoke the illegal decisions of the director of the state agency.

Agency Director

The director of the agency is selected in an open a competition organised by the respective ministry and is approved by the government for the time period of five years. The minister signs an employment contract with the director of the state agency. After expiration of the term set in the employment contract, the contract may be prolonged for a new term not exceeding five years.

To introduce and strengthen concepts of good governance in public sector, the legal act assign the head of the agency with managerial autonomy to plan the use of resources in order to achieve best results and at the same time introduces managerial accountability mechanisms through reporting on execution of the performance management agreement.

The managerial autonomy is ensured with the following:

- independence of the director to manage the operations of the agency to achieve the results;
- agency performance targets and performance indicators are set agreed between the agency and the minister, and form the basis for the performance management agreement;
- flexibility in using resources, which allows to avoid of irrational spending and cut operational costs and to improve efficiency of the agency;

¹⁰ According to Public Agency Law (2001), Articles 9, 10, 14

- financial resources are used according to the competency delegated to the agency. Reports to the ministry are submitted on a regular basis and are timely. The ministry controls execution of tasks, their quality, costs and efficiency.

On a daily basis the director of the agency organises and manages operations of the state agency, ensuring continuity of agency's activities, defines the competencies and responsibility of the employees of the agency, approves of the structure and the personnel of the state agency, sets the remuneration of the employees. The director develops the strategy of operations and development, an action plan and budget of the state agency, ensure implementation of the management agreement and provides the minister and the responsible official with the necessary information and recommendations concerning operation of the state agency. He is responsible for efficient use of public resources and the legality of the activities of the public agency.

Within the terms and according to the procedure envisaged by the management agreement the director submits to the responsible official the regular and annual reports on agency performance according to targets set in the management agreement and on financial performance.

Responsible Officer

The responsible official appointed by the minister supervises the operations of the state agency and keep minister informed about the operations. Thus he plays two roles – the sponsor and the oversight role.

The responsible officer provides the minister with an assessment of the strategy of operation and development of the public agency developed by the director of the state agency, as well as with an assessment of the annual action plan and the annual budget project and assessment of the management agreement drafted by the director of the state agency. The responsible officer sets the policy framework and strategic objectives and proposes initial performance targets for the agency on the basis of the wider sector policy framework.

Other important players

The state secretary of the ministry

The state secretary – the administrative manager of the ministry - is responsible for the implementation of the sectoral policy and the budget of the ministry to implement the policy, which includes also the budget of the agency. Thus he also responsible for efficient and effective use of all resources and proper implementation of financial resources. The officer responsible in the ministry for the agency is employed by the state secretary and the state secretary must be kept informed

Advisory board

In case the activities of the agency has an impact on interests of other ministries, the minister may establish an advisory board. The advisory board includes as its members - depending upon the specific character of activities of the state agency - authorised representatives of the state and local authorities, specialists on the given field and authorised representatives of non-governmental organisations. The responsible official, the director of the state agency or person authorised by him participates in the work of the advisory board without voting rights. The advisory board has a consultative role regarding the operation of the state agency.

Internal audit in the agency

Previously there were internal audit structures in the non-profit companies. The companies were audited by the internal auditors of the ministries. The Cabinet of Ministers has set the procedure according to which internal audit is performed in order to ensure effective functioning of the state agency¹¹.

2.3. Governance outputs

Implementation of good governance principles in the agencies is laid down and evaluated against a number of outputs and these are

- Medium-term strategic plan;
- Annual Plan;
- Budget;
- Performance management agreement;
- Reports and accounts, incl. annual public reports.

Medium term strategy of operation and development. The director of the state agency drafts the medium term strategy of operation and development of the public agency for the period of the validity of the management agreement, envisaging performance targets to be achieved in a set period of time and the necessary resources. The director of the state agency submits the medium term strategy of operation and development of the state agency to the minister for approval.

On the basis of the middle term strategy of operation and development of the state agency, the state agency develops the annual action plan of the state agency. The annual action plan defines the performance targets to be achieved during the year and the necessary activities to achieve these targets. On the basis of the annual action plan the annual budget of the state agency is approved.

Performance management agreement

The annual action plan and the annual budget of the state agency are parts of the management agreement, and each year after approval these are annexed to the management agreement.

It is an agreement on implementation of public functions, delegated to the state agency, according to the medium term strategy of the state agency approved by the minister. The management agreement on the behalf of the state is signed by the minister, on the behalf of the state agency - by the director of the agency for the time period not less than three years. With signing the agreement the agency in the person of the director undertakes to achieve results set in the strategy within the limits of approved funding¹². It stipulates:

- the quantitative, qualitative performance and cost-efficiency indicators of the state agency, including targets for public service level and customer service;

¹¹ Regulations on Internal Audit in State Agencies (No 504), approved by the Cabinet of Ministers on 11 December 2001

¹² Example Public Agency Management Agreement (No 1), approved by the Cabinet of Ministers on 22 January 2002

- the planned financial resources for performing the functions of the state agency and their sources, if necessary, other prospective resources and sources;
- the procedure and criteria for evaluation of performance of the state agency;
- the procedure for applying of financial incentives and sanctions to the employees of the state agency according to the assessment of attained performance stipulated in the management agreement;
- the need to carry out client surveys and report on the results;
- the term of the management agreement, which shall not be shorter than three years.

With the introduction of the performance management agreement necessity to carry out risk assessment was made a task for the agency director. The performance management agreement should contain potential external risk factors, which modify operating environment and are capable of affecting achievement of performance indicators and planned actions aimed at eliminating the unfavorable external factors.

Reports and accounts, incl. annual public reports

The performance management agreement sets the procedure according to which the state agency submits quarterly and annual reports to the ministry. Besides these reports the agency prepares annual public reports, which in a user-friendly language and layout should contain description of the agency, its objectives and targets and achievement of them, use of financial resources, personnel and plans for the next year.

3. WHERE ARE WE NOW – PROBLEMS, CHALLENGES, PLANS

The objective of the agency formation and performance improvement process, which was started in Latvia in 1998, is to form a state administration that works openly and is responsible to the Parliament and the community, and that delivers better quality services to the community and more effectively deals with the taxpayers' resources.

After the acceptance of the Public Agency Law in 2001, the Secretariat of Minister for Special Assignment on State Reform Issues (Secretariat) collated information about 170 non-profit companies under Ministry subordination. A thorough assessment of all companies was done first by ministries and then reviewed by the Secretariat on the basis of criteria¹³ accepted by the government.

In April 2002, the government accepted Part 1 of the schedule for companies and to be reorganised by the end of 2002, which included 25 potential agencies. Presently, the government has issued regulations for the formation of 18 agencies and 9 regulations for agency regulatory activity regulation have been accepted. In total, the number of potential agencies and assessable institutions is much larger – approximately 50. The rest – about 120 institutions (incl. educational and health care bodies) need another status.

Until now, several important problems have been identified in the Public Agency Law implementation process. Until now, several institutions not suitable for agency status have done just the surface assessment

¹³ Cabinet of Ministers 15 January 2002 instruction No.2 “State Agency formation, reorganisation and liquidation criteria”

or avoided assessment at all and have been granted agency status by the government because Ministries could ignore the opinion of the institution responsible for co-ordinating the agency formation (the Secretariat). Hence performance and function optimisation has not been used in the agencies formed, nor financial savings opportunities, because the basis of these reorganisations has been in name only. The reason for this was that mentioned above, when the Secretariat was not always able to express an independent and objective opinion about the suitability of the institution to agency status, as ministries frequently submitted it as an urgent matter for the government agenda.

Ministries and the agencies to be formed have insufficient experience in defining clear objectives and performance criteria. The performance results, along with the objectives presented in the new agency's regulations, do not always give a clear idea of the need for the formation of the agency. There is reason for concern that this operational framework will not essentially improve performance transparency and effectiveness.

To summarise the following problems have to be solved:

- ministries assessment too superficial and not challenging;
- institution responsible for driving the process forward was ill equipped to co-ordinate and challenge assessments;
- agencies being created outside defined process;
- poor quality control of changes required to become agency (objectives, targets, responsible officials);
- ambivalence of ministries and lack of strategic direction (inability to define objectives and targets for emerging agencies);
- timetable too short and ambitious.

Since a new Government took power in Latvia in November 2002, the Prime Minister has been strongly committed to reforming the state administration and civil service. As a consequence, the responsibility for management of public sector reform, including the issues of agency formation, was transferred from the Secretariat to the State Chancellery and in order to avoid the problems encountered in the agency formation and performance improvement process, the following suggestions are offered by the State chancellery to the government¹⁴:

- improve central coordination, assessment and control in the agency formation process;
- define an agency formation time frame;
- carry out the necessary changes in legislation;
- decide about the suspension of those companies transforming into agencies – until the institutions are assessed in greater depth.

¹⁴ The issue to be presented in the government in the middle of March 2003

CONSLUSION

The agency concept has appeared to work well in many OECD countries. However it is too early to say if that success can be repeated in Latvia. It is clear that successful implementation of public agencies requires more than a well written law and regulations about their operation and supervision. In particular time and resources spent on the following would never be wasted. To implement the agency concept successfully, the following issues are important:

- central co-ordination of the process
- improving the capacity of ministries to define the results they wish agencies to deliver
- improving the capacity of ministries and Ministers to oversee and manage the performance of agencies

Moreover it is essential that institution overseeing the implementation of agencies has:

- sufficient power to control the overall process – ie. to manage quality and prevent unsuitable or unready organizations converting into agencies.
- adequate resources to assess the suitability and readiness of candidate agencies
- the ability to devise and agree a clear implementation process
- the ability to clearly communicate what agencies are the conditions that surround them and the benefits they may bring.
- the leadership ability to manage a major change programme.

In Latvia not all of these conditions were present and unless they can be addressed the future of public agencies looks gloomy. However it is very clear that implementing agencies and ensuring they deliver the benefits intended is a long-term task. It requires sustained effort over several years and there are many ups and downs during the journey. So perhaps perseverance and determination are perhaps the two most valuable qualities in ensuring agencies operate effectively.

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