

# How to Reform Public Administration in Ukraine

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## Executive Summary

Ukraine consistently faces pronounced developmental challenges in its endeavors to become a competitive nation capable of promoting sustainable economic and social progress. A drastic and prompt reform of the government, which is currently fraught with numerous cumbersome and unproductive procedures of public decision making, is an urgent prerequisite to put Ukraine on a path toward growth and prosperity. The comprehensive, complete and radical revision and refinement of the role, functions and scope of the Ukrainian government is more critical than ever. A failure to improve the Ukrainian government machinery as well as further delays with all-embracing and effective public administration reform severely jeopardizes the implementation of all other economic reforms and considerably deteriorates the country's international competitiveness. Moreover, Ukrainian public institutions and administration, burdened with alarmingly weak and archaic governance, confront a mounting risk of losing control of the implementation of their core reform, regulatory and developmental programs.

**Implementation** of good **public administration reform** in Ukraine will have an immediate **positive impact** on the public welfare, economy, policies and institutions and will unambiguously result in:

- **improved functional and operational efficiency** of public governance and decision making;
- **improved capacity to implement** agreed upon measures and reforms;
- **advanced accountability** of the public sector;
- more extensive, complete and fair **coverage of citizens' needs**;
- enhanced quality, efficiency and competitiveness of **public services delivery**;
- a lower wage bill in the public sector and, consequently, a better **fiscal situation** as well as more efficient utilization of public finances;
- **reduced corruption** and higher confidence in government by the general public;
- considerably strengthened independence, accountability and impact of **local self-governance**.

Based on the successful international experience of conducting public administration reform and taking into account the current conditions of public governance in Ukraine, the following set of pressing **policy measures must be implemented without delay**:

- Define the role of the government, which will be broadly supported by all stakeholders;
- **Establish** under the Prime Minister's office a permanent and politically neutral and unbiased **Executive Group** responsible for the execution of public administration reform, with full powers to carry out the reform;
- **Approve** a coherent, feasible and logical **Concept on Public Administration** in Ukraine;
- **Carry out a horizontal functional review** of all government institutions to ensure compliance of functions with the redefined role of the government and to eliminate overlapping functions and responsibilities across agencies;
- Carry out vertical functional reviews of individual agencies to clearly define their roles and responsibilities;
- **Perform operational reviews** for the restructured agencies to improve efficiency, transparency and accountability and eliminate unnecessary processes, procedures and regulations;

- Undertake review of civil service including recruitment, promotion and dismissal practices;
- Promptly **put** into service the **newly** developed **administrative system** of public governance.

Successful **public administration reform** will:

- **put** Ukraine on a path to accelerated, balanced, and sustainable **economic development and growth**;
- **ensure the broad public commitment and consensus on this reform** and endow the reformers with social and political approval and support to further accelerate transformations of the government;
- significantly **promote** Ukraine's **international image** as a democratic country with a modern, efficient and citizen-centered government;
- **expand the role of Ukraine in the Eastern European region** as well as on the international markets.

## Introduction

Spreading global insecurity, notoriously unrelenting poverty, mounting inequality, a rapidly aging population, congested and obsolete public infrastructure as well as imminent environmental threats are just a few of the many formidable challenges that have been radically reshaping the social fabric of many contemporary economies. This growing complexity of social processes has been exacting a serious toll on the vitality of traditional public institutions. Moreover, old-fashioned administrative methods have proven to be financially unsustainable and rigid in increasing frequency. As a result, a failure to ensure balanced and sustainable growth of citizens' welfare has emerged as a real threat to the public sector. The inevitable, all-embracing and drastic revision of the governments' *modus operandi* was eventually brought to the surface. Many developed and developing countries have achieved conspicuous progress in this endeavor to establish unconventional, innovative and open governments, capable of facilitating markets and encouraging efficient use of scarce resources. As a result, a revolutionary shift from the traditional philosophy of public administration to a more flexible and practical paradigm of state relationship and cooperation with all groups of society has been observed on a world-wide scale. Countries that were able to improve national governments in that direction have managed to secure and considerably promote their competitive advantages on international markets. Hence, effective and modern public governance has firmly established itself as a critical prerequisite to create and multiply national wealth and prosperity. However, most transition countries have yet to respond to a more pressing challenge of reforming Soviet-type public institutions. Despite visible progress with economic reforms, many former Soviet nations have cultivated public institutions that are still riddled with cumbersome decision making procedures implanted by the former planned economies. Alas, most of these countries still lack the political vigor to launch broad and meaningful reform of the government. Above all, this reform requires strong leadership and broad public support, large-scale and timely policy actions as well as the unbending commitment of ruling elites to endorse democratic and market principles and values.

Ukraine has a similar priority — to discover itself as a competitive nation capable of supporting sustainable economic and social development. Recent economic opportunities have been accompanied by fundamental challenges, which cannot be adequately resolved within the established framework of the government. The rigidities and flaws of the Ukrainian administrative system both severely restrict the country's full-scale participation in the global economy and considerably undermine the responsiveness of the government to escalating economic and social pressures. The need for a broad revision and refinement of the role and functions of the Ukrainian government is more urgent than ever.

At the same time, the reinvention of the government and the alignment of its objectives with market-oriented and democratic principles are frequently accompanied by a high degree of political instability during the initiation phase. For this reason, public administration reform is a strategic policy action that is imperative to maintain political consensus in the country. Moreover, it is a necessary precondition for deeper transformations of the administrative system with an explicit objective to increase its efficiency and responsiveness to citizens' needs. Obviously, in a country like Ukraine, which still suffers from many institutional pathologies acquired during Soviet times (including inherited vast, inefficient and inflexible public administration), there is a difficult challenge to overcome intense resistance of political insiders.

Indeed, it was unreasonable to expect that a society with scarce experience of democratic and transparent institutions and elections could rapidly advance with public administration reform. Thus, the effectiveness of this reform was heavily conditional on the initial steps undertaken to improve the inherited administrative system. Consequently, the government's progress in implementing basic reforms, which would improve discipline and accountability of public administration and create a bureaucracy capable of

performing its core routine administrative functions productively, was a key determinant of the long-standing success of public administration reform. However, prior to the development of the concept of public administration reform in Ukraine, the efforts to reorganize the state administration regularly failed to follow a coherent and structured policy agenda. Adopted measures were frequently palliative, inconsistent and heavily distorted with vested interests and creeping corruption. As a result, delayed initial development of well-organized and efficiently structured public governance in Ukraine imposed major and frequently unsurpassable obstacles for the successful implementation of future reforms of the government.

Unfortunately, Ukraine's present-day public institutions still retain many inadequacies inherent in the former Soviet administration. A legacy of the communist past, they are plagued with corruption, bureaucracy, and vested interests. Decision-making is excessively cumbersome, with blurred boundaries of responsibility and authority between various government agencies. Even minor decisions require a large number of consultations and approvals, imposing an onerous burden on the domestic business community. Furthermore, due to relatively low wages in the public sector, government servants are regularly confronted with a tradeoff between impartial and professional execution of their duties and involvement in various corrupt activities. Largely unnecessary and time-consuming permits and licensing procedures encourage state officials to sell their services informally through the complex personalized networks supported by private lobbyists. As a result, despite trivial salaries, government occupations are notorious for their capacity to generate handsome informal incomes. Ukraine's public administration has now become a perpetual bottleneck blocking the country's economic development. Moreover, an over-regulated private sector and significant delays in the implementation of key economic and structural reforms have materialized as two alarming symptoms of the government's consistent failure to promote and enhance a business friendly and liberalized market environment.

Comprehensive and vigorous reform of public administration in Ukraine is an indisputable policy priority that is critical for uninterrupted progress of all other fundamental economic and social transformations. Furthermore, productive public administration reform is indispensable to put Ukraine on a path toward accelerated, balanced and sustainable economic development and growth. Otherwise, implementation of vital economic reforms will continue to lag behind the critical levels.

Clearly, the central objective of public administration reform must imply a thorough redefinition and refinement of the roles of the national government. At heart, such a government must (i) support and develop a strong private sector, (ii) secure the provision of reliable, efficient and corruption-free government services, and (iii) build efficient public governance capable of maintaining economic measures and policies that can timely and properly respond to existing and emerging economic and social challenges.

## 1. Public Administration Reform: Redefining the Role of The Government

### 1.1. The Role of the Government

Many countries eagerly pursued public administration reform to strike an appropriate balance between the state and the private sector in promoting countries' economic and social development. Over the last two decades, public administration reform encouraged national governments to assume a visibly smaller role and scale in the economy. This development came as a consequence of a more active role, which the private sector began to play across all dimensions of the public sector. Various large-scale privatization and deregulation initiatives fostered the development of much more sophisticated public-private partnerships, expanding the penetration of the private contractors into commercial activities traditionally controlled by the government. These transformations demanded a comprehensive reassessment of the role of the governments as well as the revolutionary revision of the boundaries of state interventions into the markets. In addition, provision of the essential *public goods* (goods that would not normally be supplied by the private sector due to the presence of significant externalities), and the enforcement of market friendly policies and regulatory services were placed as core priorities of the state. As a result, modern government machinery targets healthy growth of the private sector, refraining from devastating competition between private and public entities. This shift in the governments' role shaped the institutional environment, where economic and social progress can be maintained on a sustainable basis.

A radically new vision of the government's role accelerated the transfer of many functions, previously monopolized by the state, to the private domain. Many countries initiated public administration reforms as a response to budding concerns of whether the public sector and institutions have the capacity to achieve efficiency levels comparable to private sector performance. Indeed, the private sector enjoys considerable competitive advantages to produce and supply goods and services, even if these goods and services are consumed by the population as public goods. Private businesses constantly face merciless competitive pressures to increase productivity through innovations and technological modernization. Apparently, the speed of the public sector to adopt new technologies and cut costs may be considerably checked by the virtual absence of rivals. This incapacity to catch up with the private sector in terms of productivity and efficiency growth is identified as the *failure of the government*<sup>1</sup>. However, the private sector may fail to deliver public goods as well (*market failure*<sup>2</sup>). Therefore, the refinement and reassessment of the government's role indispensably relies on the balanced approach towards the elimination of market and government failures. Furthermore, a review of successful international reforms and tactics to replicate them in Ukraine should become a critical element of frictionless public administration reform.

Obviously, the vision for the government's role in society and, consequently, the scope of its attachment to private sector activities varies across countries. In some countries, governments are explicitly distanced from direct involvement in commercial activities but assume an enhanced role in the provision of business regulations. In addition, in such countries (for example, United States, New Zealand, Australia) governments typically maintain vital infrastructure facilities that are crucial to the functioning of private businesses. Yet another group of countries (for example, EU member states as well as some transition economies) gravitate to a more interventionist type of government. However, in most democratic

<sup>1</sup> *Government failure* refers to situations when the public sector cannot ensure efficient delivery of services and goods to the public. Unlike market failure, government failure is a more recent notion of public sector economics and originated from the widespread initiatives to rethink the role and functions of the modern state.

<sup>2</sup> *Market failure* reflects situations when the market per se does not allocate resources efficiently. In general, the source of market failure may be rooted in imperfect competition, externalities, public goods and information asymmetries. Many mainstream economic schools have been consistently employing this concept to justify state market interventions.

nations, the extent of such interventions tends to vary across countries depending on specific cultural, social and economic backgrounds.

The development of policy tools and institutions that boost efficiency of public administration remains the subject of unending debates in both academic and policy-maker circles. It is indisputably recognized that a failure to allocate sufficient attention to this issue carries significant damaging implications for the country's capacity to maintain its economy on course for strong growth, improving social welfare and a mature and friendly market environment for private businesses. Such efforts rely on a broad set of comprehensive policy measures, which target and solve both country-specific issues as well as challenges brought on by the global economy.

The pressure to rethink the role of the state in modern society has recently been intensified in the global arena, as resource-constrained governments are consistently being confronted with many new obstacles in formulating and implementing effective public policy. For many governments, such issues as business deregulation, reduction of the number of civil servants, foreign trade and financial markets liberalization, and improvement of fiscal environment were the major challenges that ignited the reinvention and critical revision of the state's *modus operandi*.

A principal attribute of the process, initiated to identify *new roles* of the government, was a wide-scale shift in focus from the *government* to *governance*. In particular, accents of public administration reform were changed from a mere renovation of the institutional fabric of the government to the redefinition and perfection of all functions fulfilled by its various structural divisions. Effective governance facilitates collective decision making in the public sector, the private sector and a civil society, and it drastically improves cooperation and coordination between all these players. At heart, it demands active collaboration and participation of all parties to improve public administration in the country. However, such collaboration entails an unavoidable combination of benefits and risks. The risks may arise as a result of a failure of the government to recognize and accept its distinctly new obligations and authority under the reorganized social partnership patterns. Moreover, advantages, accruing to the society at large, should be protected by the strong commitment to increase public sector efficiency through innovative managerial strategies rather than through the conventional dependence on the excessive use of unreasonably rigid and restrictive laws and regulations.

## 1.2. Overview of Public Administration in Ukraine

Ukraine's public administration is still poisoned with alarming design flaws that impose an onerous burden on the government to draft and implement prudent economic and social policies, deliver vital public services at a high quality level and utilize public funds efficiently. The core of public administration, supporting effective implementation of public policies designed by political leaders, is still immature. Notwithstanding visible improvements, the institutional framework of the government has a rather patchy structure in which some structures were extensively reformed to improve policy implementation, while many other agencies and procedures still contain severe administrative defects. As a result, the government's overall capacity to execute policies and undertake effective collegial decision making is rather weak due to the absence of reliable internal control as well as frictionless and productive intergovernmental coordination.

During the transitional period, the government was challenged to perform many new unfamiliar functions that were frequently beyond available competence and expertise. As many new functions and agencies were merely implanted into the existed machinery of the government without a comprehensive review of its capacity to support and execute necessary operations, the overall functional efficiency has not



been radically strengthened. Furthermore, a critical revision of the new roles of the state in the emerging market economy was not undertaken. For this reason, despite the fact that the existing structure of public administration contains many essential components, the entire administrative system still fails to operate as a well-tuned mechanism. The issue of intergovernmental coordination is of key importance in Ukraine. Ongoing transformations of public institutions in Ukraine fail to gain full speed due to the weak enforcement of transparent and unambiguous procedures regulating intergovernmental interactions and the absence of a clear-cut vision of the role and authority of various government agencies.

#### Box 1: Legacy of the Soviet Past

Without exaggeration, present imperfections of the state administration are an ineluctable legacy from the public decision making inherited from the Soviet past. In particular, the Soviet administrative system lacked an explicit separation between the political and administrative functions of the state institutions, which delayed the development of an autonomous and productively functioning administrative bureaucracy. Under the central planning regime, the allocation of resources was of primary concern to state officials, who exercised a significant degree of discretion in their decisions on the distribution of rewards and resources within the system. As a result, the informal personal network became a fundamental component of the state administration at every level. Even though the Soviet public institutions were fairly well structured, the adherence to formal rules and procedures was of inferior importance. Top state officials often enjoyed considerable personal authority securing their influence through the appointments of trusted persons to key positions within these institutions. Hence, non-transparent, corrupt and narrow-interest practices penetrated into the heart of the Soviet administrative system. Obviously, enormous inertia and resistance of insiders to structural changes helped to preserve the influence of informal personal networks in the modern public administration of Ukraine as well.

**Table 1.1: Governance Indicators**

	Ukraine							Russia	Poland	New Zealand
	1996	2002	2003	2004	2005	2006	2007	2007	2007	2007
<b>Voice and Accountability</b>										
Estimate (-2.5 to + 2.5)	-0.3	-0.58	-0.67	-0.58	-0.37	-0.17	-0.09	-1.01	0.81	1.49
Percentile Rank (0-100)*	38.8	31.7	30.3	31.3	37	43.3	45.2	20.2	71.6	97.1
<b>Political Stability</b>										
Estimate (-2.5 to + 2.5)	-0.23	-0.2	-0.31	-0.39	-0.37	-0.06	0.16	-0.75	0.58	1.24
Percentile Rank (0-100)	37	39.4	36.1	32.7	34.6	43.8	50	23.1	66.8	94.2
<b>Government Effectiveness</b>										
Estimate (-2.5 to + 2.5)	-0.75	-0.71	-0.53	-0.68	-0.4	-0.5	-0.6	-0.4	0.38	1.90
Percentile Rank (0-100)	22.7	26.5	34.6	27	39.3	35.5	29.9	42.2	67.3	95.7
<b>Regulatory Quality</b>										
Estimate (-2.5 to + 2.5)	-0.5	-0.65	-0.66	-0.46	-0.3	-0.48	-0.42	-0.44	0.71	1.74
Percentile Rank (0-100)	26.8	26.3	25.4	38	45.4	34.1	36.4	35	72.3	96.6
<b>Rule of Law</b>										
Estimate (-2.5 to + 2.5)	-0.54	-0.84	-0.85	-0.71	-0.57	-0.77	-0.7	-0.97	0.28	1.91
Percentile Rank (0-100)	35.2	23.8	22.9	28.1	37.1	25.2	27.6	16.7	59	98.1
<b>Control of Corruption</b>										
Estimate (-2.5 to + 2.5)	-0.82	-0.97	-0.9	-0.9	-0.59	-0.65	-0.73	-0.92	0.14	2.36
Percentile Rank (0-100)	24.8	15.5	17.5	19.4	36.9	31.6	26.6	16.4	61.4	98.1

\* Percentage of countries, where a governance indicator is below the level observed for a selected country

Source: World Bank, Governance Matters 2007, Worldwide Governance Indicators 1996-2006

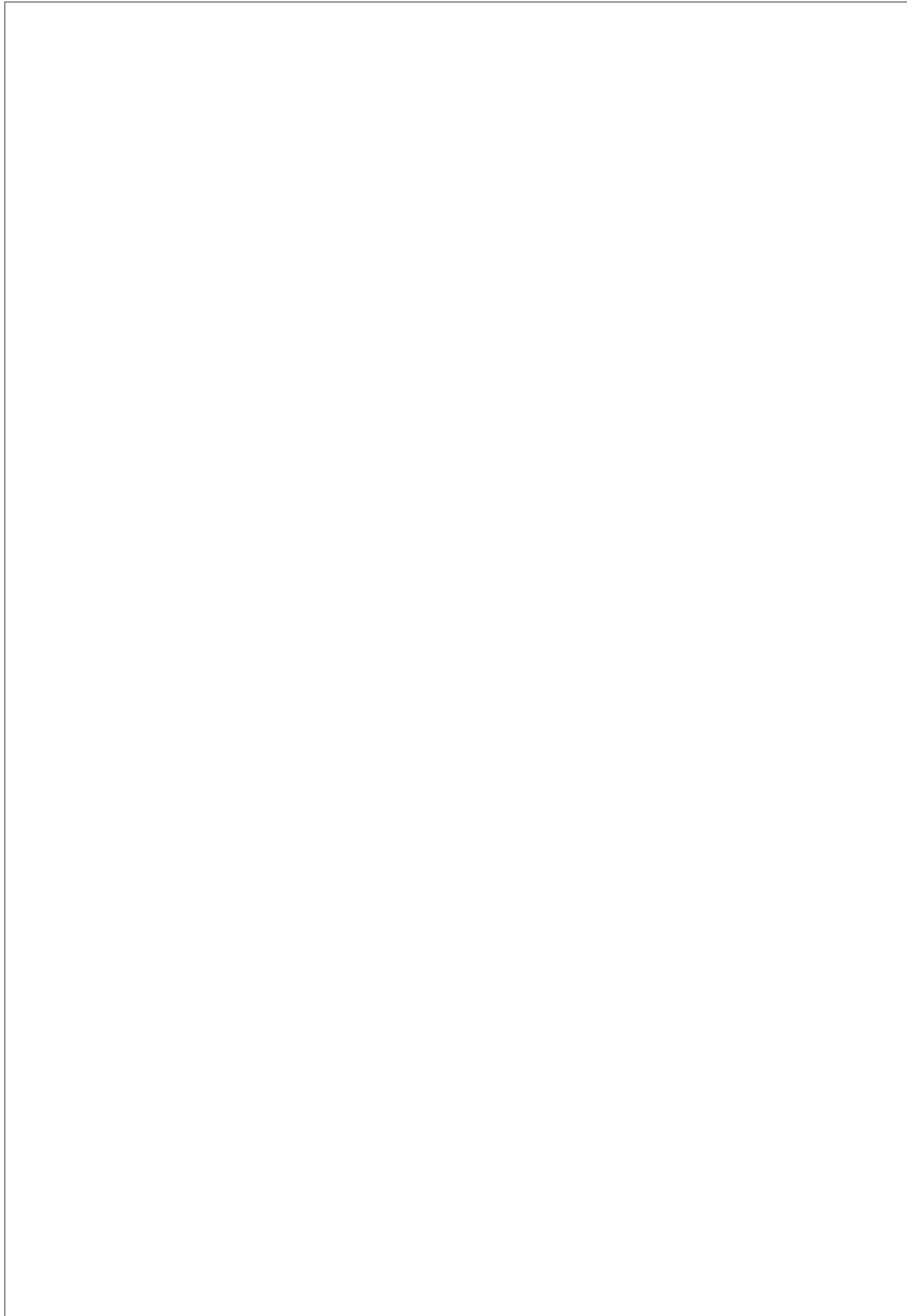
Lacking a consensus vision on the organization, authority and functions of the government, Ukrainian body politic, handicapped by the vast pervasion of vested interests, has shied away from the development of an effective and feasible strategy of public administration reform. The evolved structure of public administration in Ukraine is characterized by excessive bureaucracy, absence of clearly defined boundaries of authority between various state institutions, overlaps of responsibilities and duplications of key functions, inadequate policy-making capacity, lack of accountability and weak financial and budget discipline.

The Ukrainian government ranks below 60% of over 200 countries rated by the World Bank. Notwithstanding obvious improvements in 1996–2005, the quality of public governance in Ukraine visibly deteriorated in 2006 and 2007, particularly in terms of government effectiveness and control of corruption. Although these indicators represent respondents' subjective perceptions of the efficiency of the Ukrainian government, they provide valuable information for a cross-country comparison. While there is an encouraging sign of progress observed for some public governance indexes, the overall performance of public administration in Ukraine still fails to match the levels achieved, for example, by Poland and is significantly weaker than the performance of public administration in developed market economies, such as New Zealand. The overall picture appears rather disturbing as the government of Ukraine still has a way to go to achieve the quality of public administration comparable to its successful neighbors. Furthermore, the quality of public administration cultivated by developed market economies is surely unattainable for Ukraine at least in the medium term. Obviously, weak public administration puts a huge strain on Ukraine's competitiveness on global markets.<sup>3</sup> Thus, it is essential to accelerate public administration reform. Otherwise, Ukraine will continue to lose its competitive edge despite vast indigenous economic advantages.

The ability of the central and local governments to execute prudent economic policies and programs relies heavily on the overall functional and operational efficiency of the entire administrative system. Building institutional capacity of the Ukrainian government is a basic step to facilitate policy making and reduce the risks of improper implementation of social and economic strategies of the country. For this reason, public administration reform in Ukraine is indispensable for the success of all essential economic and social reforms. As long as various administrative inefficiencies continue to persist, the impact of good public policies on economic development will be limited.

Indisputably, public administration reform is a top priority on the policy agenda of the government of Ukraine, which must be integrated into the legal system through comprehensive and balanced legislative initiatives. At the same time, it must be taken into account that this reform per se is a fragile evolutionary process that is built into the never-ending transformations of the political landscape in the country. Obviously, the progress of this reform in Ukraine is particularly sensitive to significant political changes. For this reason, Ukrainian policy makers should treat public administration reform as a vital step to rethink the role of the government and establish administrative and regulatory capacities enabling full-scale promotion of economic and social interests of the population. It is crucial to ensure a consistent and systematic policy approach to this issue as any political disturbance that disrupts the execution of public administration reform impedes the formation of a clear set of policy rules and procedures that can be effectively applied to achieve policy implementation and execution at an adequate level.

<sup>3</sup> Global Competitiveness Report 2007–2008 puts Ukraine at the 75<sup>th</sup> place out of 131 countries rated. According to this report, the quality of institutions, ranked as low as 115 out of 131, is a major setback for economic growth and development.



an environment were either postponed or only partially implemented. In addition, the existing institutional culture of the government was not conducive for the incorporation and development of such an administrative core, as informal personal networks continued to flourish. As a result, the position of state secretaries was abolished in 2003 and replaced with the first deputy ministers.

The concept of public administration reform in Ukraine was a significant step toward the launch of the government's restructuring. However, the implementation of this concept was below expectations. A principle hindrance to the fast and meaningful transformation of the state administration in Ukraine was rooted in the uneven progress of various components of this reform. Initial efforts were largely biased toward the restructuring of the Cabinet of Ministers and were closely supervised by top political officials. Although this initiative secured the necessary support from key political figures, it was frequently narrowed to a mere rebranding or liquidation of selected ministries or state departments. As a result, this process often involved a change in either statuses or titles of the state agencies under reorganization, while most of the functions performed by these agencies were preserved.<sup>4</sup> Though some of the functions of liquidated state authorities were transferred to the existing ministries or were delegated to newly created departments, a thorough evaluation of whether these functions are redundant or can be performed by the agencies to which they were delegated was practically absent. The duplication and overlapping of many functions and responsibilities within the central government were inevitable outcomes. In addition, frequent reshuffling of top officials who run the committees responsible for public administration reform as well as numerous amendments to the relevant legislation have considerably postponed the development of a comprehensive long-term strategy of this reform. As a result, the process of public administration reform did not evolve along the well-defined and stable policy guidelines, but mostly represented continuing and rather erratic organizational reshuffling of CEA administration.

The institutional discontinuity of agencies implementing public administration reform<sup>5</sup> may to some extent account for the overall protracted execution of this reform. Currently, government agencies that are responsible for public administration reform function within the structures of all branches of power. The Parliament of Ukraine runs a committee on state administration development, local self-governance and regional development, while the secretariat of the President supervises the national council on issues of coordination between state administration and local self-governance. In addition, a department on public administration reform exists within the secretariat of the Cabinet of Ministers. A position of the Vice Prime Minister on the issues related to Public Administration Reform was introduced in 2005; however, it was abolished in 2006. Alas, the level of cooperation between these agencies is still insufficient to establish a coherent and shared attitude towards administrative reform in the country.

The slow progress of public administration reform is obviously rooted in the inadequate extensiveness and transparency of legislation with respect to responsibilities and functions of the central executive authorities. The Constitution of Ukraine allowed for the existence of two centers of executive power — the President and the Cabinet of Ministers. However, it did not draw explicit boundaries of authority and responsibilities for these institutions. As a result, many unsuccessful attempts to fill the legislative vacuum (for example, the adoption of the Law on the Cabinet of Ministries was plagued by a protracted political

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<sup>4</sup> Several legislative initiatives were undertaken to form a more transparent and accountable structure of the central executive power. In December 1999, the President of Ukraine issued a decree "On the Changes of the Structure of Central Executive Authorities," which attempted to establish a clear administrative structure of the central government. However, this legislation has been already modified 45 times since its adoption.

<sup>5</sup> In 2005, the national council on the coordination of the functioning of central and local governments was replaced with a national council on state administration development, local self-governance and regional development, which in 2006 was renamed to the national council on the issues of state administration and local self-governance. At the beginning of 2008, the national council on the issues of state administration and local self-governance was replaced with the national council on the issues of coordination between state administration and local self-governance. At the same time, the committee for the implementation of public administration reform was liquidated.

stalemate between rival political factions)<sup>6</sup> considerably constrained the implementation of public administration reform. Moreover, the Cabinet of Ministers Regulations replaced provisional regulations only in 2007.<sup>7</sup> However, provisional regulations, effective prior to 2007, were insufficiently applied in practice due to weak policy-making capacity of the ministries and state departments and a significant workload on the Cabinet of Ministers in terms of the large number of draft laws under consideration and tight deadlines. As a result, the collegial decision making within the Cabinet of Ministers became rather cumbersome and is heavily burdened with excessive bureaucratic procedures. Moreover, the government is still in the process of modernizing key policy instruments (such as medium-term strategic program and budgeting processes) as well as specific procedures that can effectively incorporate these instruments into the existing system of state administration. These procedural bottlenecks place serious constraint on the ability of the government to adopt and implement economic policies. Moreover, existing flaws in the state management visibly impair the responsiveness of the government to various economic and social challenges. For example, efforts to stabilize consumer prices without reliance on restrictive administrative measures have recently failed for the umpteenth time.

The constitutional reform of 2004 was initiated to improve the efficiency of the central government and refine the areas of authority and responsibilities of the President and the Cabinet of Ministers. According to the approved constitutional amendments, the center of the executive authority and administration was shifted to the Cabinet of Ministers formed by the Parliamentary Coalition. Although new constitutional provisions redefined and refined the boundaries of authority of the President and the Cabinet of Ministers, many controversial issues are still present and have to be resolved through well-structured secondary legislation.<sup>8</sup> Admittedly, the new Law on the Cabinet of Ministers eliminates several conflicting provisions on the organization of the Cabinet of Ministers. However, this law is just the first step on the path to rationalize Ukrainian legislation. Obviously, the quality of secondary legislation that governs internal procedures, coordination and decision making within the government is as important as the consistency of primary legislation (Constitution and other key laws). Therefore, ongoing harmonization of primary legislation must be accompanied by relevant amendments to supporting laws that create an environment enabling effective policy drafting and implementation. Existing chronic legislative and functional ambiguities call for a comprehensive reassessment of roles, programs and functions of the government. This initiative will help to unlock the formation of core independent administrative bureaucracy operating on the basis of well-tuned and duplication-free legislation.

#### 1.4. Policy Recommendation for Ukraine

Within the current global economic environment, the established state administrative system consistently fails to function effectively in Ukraine and spells serious problems for the sustainable economic development of the country. There is an urgent call to rethink and revise the role of the government in Ukraine to ensure continuation of economic growth and consistent improvements of social welfare through prudent implementation of good public policies. Straightforward decentralization and scaling down of the public sector must go together with new approaches to management advancing

<sup>6</sup> At the beginning of 2007, the Parliament overcome presidential veto on the Law on the Cabinet of Ministers (approved in December 2006), the President, in turn, appealed to the Constitutional Court of Ukraine to question the correspondence of this Law to the Constitution. Only in mid-May 2008, the new Law on the Cabinet of Ministers was approved by the Parliament and signed by the President.

<sup>7</sup> Cabinet of Ministers Regulations were enacted by the resolution of the Cabinet of Ministers No. 950 in July 2007.

<sup>8</sup> Such political process is complicated by the insufficient depth of effective legislation, which does not allow for unambiguous interpretation of problematic provisions built into the Constitution. Neither the Constitutional Court of Ukraine nor the Parliament has yet successfully resolved this issue. Since the Constitution is a primary source that defines the scope of authority of the highest-ranking state institutions, stalled resolution of Constitutional gaps delays the development of effective coordination between various centers of executive power and often leads to contradictory and conflicting actions performed by authorities.

accountability, flexibility and responsiveness of the government. Furthermore, recent developmental challenges faced by the government require public authorities to act as mediators and supporters, actively seeking partnerships with the private sector, civil society and nongovernmental organizations. Although Ukrainian authorities have been putting much effort into developing prudent public policies, the progress with public administration reform is still worryingly mixed and unsatisfactory. Undeniably, a synergy between government reform and new administrative, managerial and information technologies opens many opportunities to redesign and improve the public sector in Ukraine. Thus, the Ukrainian government must be willing to capture these efficiency gains through the balanced and active restructuring of public administration, backed by the critical revision of the role and functions of the state in the increasingly competitive global economy.

A comprehensive and shared vision for the role and function of the government is a key prerequisite for productive public administration reform in Ukraine. All authorities that have a stake in this reform and are affected by the government's restructuring must achieve a formal agreement on the implementation of the reform by adhering to common goals and objectives and, most importantly, through the clear perception that such reform is indispensable to advance policy making capacity in Ukraine.

- **Authorities should maintain strong leadership through their commitment to proceed with public administration reform. Without such leadership, it would be difficult to consolidate the efforts of all parties involved in reform as well as shape and achieve common targets.** For this reason, public administration reform must be formally prioritized as a key item on the government's agenda.
- **It is imperative to form an executive and competent state agency that will be endowed with a broad mandate to monitor, control, revise and execute the concept of public administration reform in Ukraine.** The concept of public administration reform has to be critically rethought and modified so that it reflects the current conditions of the state administration and offers a feasible solution to existing problems. In addition, it is necessary to develop measurable performance targets<sup>9</sup> against which the result of reforms can be assessed.
- **A comprehensive plan of action for the implementation of the concept of administrative reform must be approved by the government. This plan should be designed as a broad policy instrument rather than a mere statement of intentions.** For this reason, the feasibility of the concept of public administration must be thoroughly evaluated, since the reform schedule must account for existing institutional and procedural weaknesses and obstacles that may put off the execution of the concept. Extensive efforts should be devoted to the development of the capacity of the government to reform public sector management. Furthermore, the authorities should refrain from a gradual or incremental approach and adopt a radical and comprehensive program to overcome inertia and opposition of bureaucratic insiders. It is therefore fundamental to enact this program through a formal agreement supported by top state officials.
- **The action plan on public administration reform should represent a well-structured and detailed list of activities and measures to be implemented under the reform program, including specification of clear-cut targets, timing, deadlines, and the distribution of responsibilities between all involved state agencies.** It is necessary to ensure that each participating agency understands its role and responsibility during every phase of the reform, as well as have a

<sup>9</sup> For example, reducing the share of budget funds spent on public administration or cutting the size of civil service employment could be straightforward and practical goals of reform. The set of performance measures to evaluate the quality of public administration is rather extensive. The perception of the quality of public services supplied by the government to the final consumer is one of the possibilities. Furthermore, regular surveys that monitor the professional level of civil servants and the ability to draft, review and implement key legislation within a reasonable period of time should not be ignored when the impact of public administration reform on policy making capacity is estimated. At the same time, it should be acknowledged that the capacity of the Ukrainian government to undertake sophisticated performance measurement of the quality of public administration requires significant modernization as well.

comprehensive perception of the final outcome of the reform and its role in the new structure of the government. It must be clearly realized that the implementation of this action plan will be carried out by the means, instruments, resources and procedures currently available to each specific state institution. Therefore, the allocation of responsibilities and roles during public administration reform should be weighted against the capacities and resources of every involved party to which specific duties are to be assigned. Obviously, this capacity of many state institutions should be further strengthened to conduct efficient reform of state administration.

- **A clear and extensive definition of the role of government and the scale of the public sector must be the key element of the action plan on public administration reform.** It should be recognized that the operations of state should be restricted to non-commercial activities and can only be justified by the failure of the private sector to provide a narrow set of public goods and services. The government should clearly demarcate the boundaries of its core activities (such as national defense and security) and firmly commit to market oriented policies and business regulations that enable private-sector led growth unconstrained by wasteful competition with the state.
- **It is necessary to achieve timely and synchronized harmonization of the legislation currently in force with ongoing revisions of the role of the government. Obsolete and rudimentary laws and regulations that damage market competition and allow for state interventions must be promptly eliminated.** The legal framework of the government should be improved and systemized to develop a transparent structure of state institutions facilitating policy implementation and the achievement of goals that comply with functions and priorities of the public sector.
- **The institutional framework of public administration reform must be properly shaped.** The revision and modernization of the state's role and function should be maintained on a regular basis through the application of innovative technologies and modern managerial skills in the public sector. The government should create and support educational and research networks, facilities and institutions that actively encourage the diffusion and utilization of this knowledge within state institutions and advance civil service and its human capital capacities.

## 2. Functional Review of the Government

### 2.1. International Experience

International experience with public administration reforms suggests that a well carried out functional review is a key element determining the effectiveness of the reform. The primary targets of all functional reviews include (i) the elimination of the overlaps between activities performed by various government agencies and departments; and (ii) the prevention of excessive fragmentation of the government. Timely and successful achievement of these goals will ensure adequate renovation of existing government programs in the country, proper transfers of certain types of activities from the public to the private sector, as well as broad organizational restructuring of government agencies.

Typically, an effective functional review is carried out in two parallel directions: (i) *horizontal* and (ii) *vertical*. *Horizontal review* is conducted on same-level government institutions aiming to define overlapping responsibilities. In contrast, *vertical review* is conducted on different levels within one institution and focuses on the issues of organizational effectiveness and prevention of excessive fragmentations between the agency's substructures on the same vertical.

The focus of the functional review may shift between (i) the identification of core government functions, (ii) elimination of existing duplications in government agencies' activities, and (iii) options for the consolidation of various government agencies. Notably, international experience suggests that the sequence of the functional review was quite identical in all countries and included two basic stages — the inventory of all existing government functions and identification of functions, which have to be (i) eliminated, (ii) kept in the "hands" of the government and (iii) delegated to the sub-national government or outsourced to the private sector.

Furthermore, any productive functional review should be designed and managed as an integrated cooperation initiative. The most effective implementation of such a review relies on (i) the strong specialized central coordination group/unit to manage a process and develop precise recommendations to improve the functional quality of all government agencies; and (ii) internal self-assessment and justification of all functions currently fulfilled by each government agency.

One of the main outcomes of this functional review are (i) improved operational efficiency of the administrative system, (ii) a reduction in the administrative costs of the governmental machinery, and (iii) better quality of services delivered by state agencies.

#### ***Canadian Experience of Conducting Functional Review***

##### *Approach to functional review*

The successful Canadian experience of implementing functional reviews offers a set of crucial prerequisites that are necessary to maintain the process at a high efficiency level:

- strong political will to reform the country's system of public administration by increasing its efficiency and making it more competitive in serving public interests;
- a highly competitive small team of experts (a task force) with advanced knowledge and experience in the field of conducting functional reviews who are endowed with a broad mandate by the central government to (i) develop all necessary methodology, (ii) act as a coordination unit for the



entire process of functional reviews in all government agencies, (iii) summarize results, and (iv) recommend measures on re-scheduling state functions.

This centralized task force should review each government program based on six criteria:

- public interest of having a specific program;
- roles of the government agency managing this program;
- jurisdictional alignment;
- external partnership;
- business principles;
- affordability for the government to perform this program.

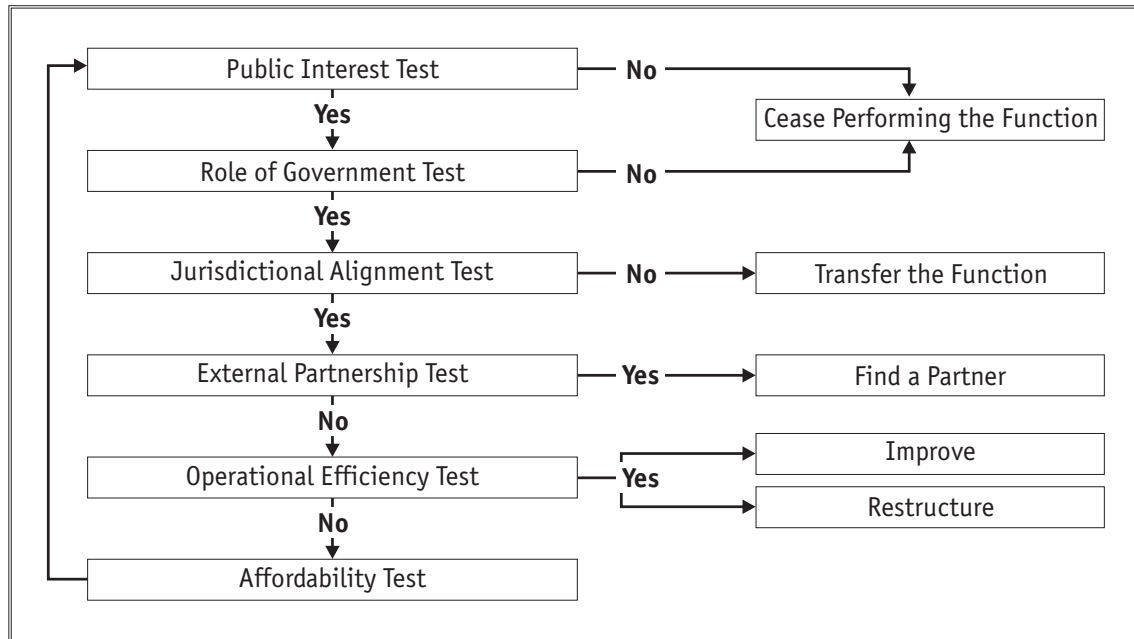
These criteria were simplified and summarized in a set of questions to be answered by every agency under review. Gathered questionnaires were thoroughly analyzed by the central group responsible for the implementation of both this review *per se* as well as public administration reform in general:

**Table 2.1: Six Criteria of a Typical Functional Review**

Criteria	Question to analyze the defined criteria
Public interest of having a specific program	Does the program/service serve a public interest?
Role of the government in conducting this program	Is there a legitimate and necessary role for the government in this program/service?
Jurisdictional alignment	Is the lead responsibility for this program/service assigned to the right government jurisdiction?
External partnership	Could, or should, this program/service be provided in whole or in part by the private sector?
Business principles	If the program/service continues within the existing government context, how could its efficiency and effectiveness be improved?
Affordability for government	Is the program or service affordable within the existing fiscal realities?

The revision of the Canadian public administration system was, therefore, based on the comprehensive and complete information on various roles and functions performed by every central government agency. As a result, the key advantage of this approach was the ability to gather and code all necessary information in a form of clear and unambiguous answers to a set of questions, derived from the previously mentioned six criteria. Availability of this well-structured data allowed launching productive analysis of the entire administrative fabric of the Canadian government. The methodology of such analysis was essentially simplified to a clear-cut and powerful algorithm aiming to justify or terminate the preservation of each reviewed public program/service in the government's *activity portfolio*. Only in the case when a specific public program/service passed all established criteria was it retained in this portfolio. Furthermore, strict adherence to this methodology fixes the strategic focus of the entire functional review on two key processes: (i) narrowing the scope of government activities and (ii) optimization of the public management process.

**Figure 2.1: An Algorithm of the Canadian Functional Review**



After the functional review of the central government was finalized, the identical methodology was applied at the local/province level, where similar coordinating/expert groups were established. As a result, the functional review was successfully accomplished at both the central and local levels.

*Outcome of the functional review*

The results of the Canadian functional and program reviews, as a part of the broad public administration reform implemented in the country, were strikingly productive. In particular, over 80 new alternative service delivery arrangements were created, as many public services were outsourced to private suppliers under the special contracts signed with the country's government. There was a significant improvement in the country's fiscal situation, as Canadian public administration reform yielded a sizable cutback of total government spending on different state programs. This reduction amounted to 4 percentage points of GDP (down to 12% from the pre-reform level of 16% of GDP) and was equivalent to a \$8 billion savings of public funds. The number of public servants shrunk dramatically as the total employment of public servants decreased to 45% of its initial level. The released number of public servants was around 55,000. The new alternative service delivery mechanisms considerably expanded the involvement of the private sector in the public service provision. These mechanisms were arranged as signed contracts with (i) 18 private companies responsible for passport services, consulting, and training services; (ii) 3 legislated service agencies, which assumed the responsibility for food inspections, and public park maintenance; (iii) 100 crown corporations in charge of mail services and national broadcasting; (iv) 132 foundations and shared governance corporations in charge of civil air navigation and airport maintenance; as well as through numerous private-public partnerships, and widespread contracting and outsourcing.<sup>10</sup>

Finally, the design of Canadian public administration reform put special emphasis on issues related to public awareness, treating this subject as one of the highest priorities. On one hand, the general public was kept systematically informed on the final objectives of the functional review as well as on the scope of its potential benefits and advantages. On the other hand, public servants were effectively motivated to be

<sup>10</sup> Wilkins, J. (2003).

actively engaged in this process by cultivating the internal perception of functional review as a powerful tool to promote transparency and eliminate excessive complexity of public servants' duties and responsibilities. This approach secured broad public support and commitment and allowed the government to minimize the resistance of insiders to structural changes.

### ***Kazakhstan's Experience of Conducting Functional Review***

Public administration reform in Kazakhstan was highly supported by the country's leadership. The reform started by moving the capital from Almaty to Astana. This relocation of capital and, consequently, all government agencies to the new place left many government employees in the former capital. Since many government employees were not willing to move to a new place, the government received a chance to employ new professionals — many of whom were trained abroad and were able to bring know-how into the old soviet-style system of public administration.

In 1998, as a phase of public administration reform, Kazakhstan undertook a functional review of its government, with the main objective to decrease budget expenditures for 1999. The sub goals included:

- redesign government functions by making them more market oriented;
- eliminate all inappropriate functions currently performed by the state;
- restrict funding of functions to available 1999 financial resources.

Formally, the process was launched by appointing the First Deputy Prime Minister, who was also in charge of Kazakhstan's Budget Commission, an oversight body for conducting the country's public administration reform. However, the Ministry of Finance was appointed as the executive unit responsible for day-to-day operations of the "public administration group". The activities of this ministry embraced reform of public administration in the country, including:

- review of all state funded functions and programs;
- identification of all state funded functions that can be transferred from state funded to the management of Non-budgetary State-owned Enterprises;
- development of the concept of consolidation of budgetary entities' off-budget revenues into the budget;
- promotion of competition in the country's healthcare and education sectors, and a reduction of public expenditure for these purposes.

It was expected that after the implementation of public administration reform, the number of central government public servants would be reduced by nearly 25%, or by about 25,000. In addition, administrative reform was anticipated to produce the following transformations of the administration: (i) clearer functional definition of government agencies; (ii) significant decrease in the number of budgetary entities; (iii) reduction of the state government wage bill, (iv) reduction in the amount of administrative expenses, (v) developed unified mechanism of human resource management for all central government agencies, including hiring, promoting and training of civil servants.

### ***Outcome of the functional review***

Kazakhstan's reform of public administration was able to accomplish practically all of the objectives that were initially declared. The size of government employment was reduced by around 20%. Most of the decision making processes became more transparent and effective. The functions of all state agencies were

much better defined, while the transparency and accountability of their activities were notably enhanced. Moreover, many initially existing overlaps within the state administration were promptly eliminated.

The lessons of Kazakhstan in conducting functional review and public administration reform in general suggest that the effectiveness of such reforms could have been further strengthened if some of the retained functions had been transferred from direct government influence to "private hands" rather than to the Non-budgetary state-owned Enterprises (NBSOE). The practice with NBSOE in Kazakhstan implies that a delegation of some of the functions to these entities represented a compromise between complete and broad restructuring of the government machinery and the realities of the country's system of public administration. Although NBSOE were new entities created by the government to boost the efficiency of public management, some of them frequently replicated administrative practices of the old government system. In particular, the decision making process remained relatively cumbersome within these enterprises. In addition, the effectiveness of reforming public administration in Kazakhstan could have been even higher if a very clear and consistent framework of this reform was developed at the stage of reform initialization.<sup>11</sup>

### ***New Zealand Experience of Conducting Functional Review***

New Zealand was the first country that launched a comprehensive functional review of the government back in 1984. The eagerness of the government to proceed with revolutionary public administration reform was driven by intensifying social and political pressures to trigger radical restructuring of the public sector, which confronted many formidable challenges after the financial crisis of 1984. In particular, the government of New Zealand faced an urgent need to address the fiscal deficit and the low level of efficiency of public service delivery. The principle justification for defining this strategic goal was an assumption that many of the existing government functions, which were performed at that time by different state agencies, could be more efficiently executed by the private sector. Therefore, the methodology of the process was tied to the model of Contract State - the private sector is more efficient in managing resources and as many functions as possible should be outsourced to private contractors. Each government function was tested against two criteria - (i) whether this function has to be financed by the state budget; (ii) whether it is possible that this function will be successfully done by the private sector and not by a government agency or institution. Functional review in New Zealand was organized strictly in a top-down direction. The process was highly centralized and managed by a group of experts.

#### *Outcome of the functional review*

As a result of this reform, New Zealand was able to downsize its public service by around 50%. 2,700 state-owned companies were either transformed into commercially-driven public corporations or were privatized. All of the former state entities transferred to the private sector were endowed with a high level of operational autonomy. In addition, a special system of motivation was established that provided incentives for operational/managerial companies to contract the government under performance agreements with ministers. All chief executives in operational/managerial companies were given time-limited contracts that were based on the performance of the company.

## **2.2. Initiatives on the Functional Review in Ukraine**

Although better functional efficiency of the public administration is frequently called for, the Ukrainian government still devotes insufficient efforts to this issue. Similar to many other components of public administration reform, functional review fell victim to the absence of a well-structured and consistent

<sup>11</sup> There were frequent revisions of the reform implementation schedule. As a result, the duration of reform significantly exceeded the initially planned time period.

approach. Indeed, the functional review lacks strong centralized supervision, while the methodology and procedures for this review are being drafted at a snail's pace as there is no clear assignment of responsibility for this process within the government.

At the end of 2006, several attempts were made to accelerate functional review of state institutions. In November 2006, a coordination council on the functional analysis of the central and local executive authorities under the Cabinet of Ministers was established. Although the coordination council is expected to oversee overall performance of the functional review, the field execution of this review was assigned to every state agency. However, the internal capacity of various state institutions to proceed with the functional review is still worryingly weak. The first provisional methodology of the functional review was issued by the Department of the Civil Service of Ukraine (DCSU) only in July 2005.<sup>12</sup> It stipulates that the functional review should be performed by the working groups created by each state agency, while overall coordination of the review is administered by the DCSU. Each working group must include key officials of the agency under review, representatives of other state agencies as well as various independent experts on public administration<sup>13</sup>. A working group is supposed to evaluate every function of the state agency based on the following four criteria:

- *legality* — whether a function complies with the Constitution and Laws of Ukraine;
- *correspondence to political priorities set* by the President and the Cabinet of Ministers;
- *effectiveness* — whether a function serves public interests;
- *efficiency* — whether a function is performed in the best possible way.

First, this process attempts to integrate the elements of upstream functional review (which intends to structure state functions according to general policy priorities) and the components of a pure efficiency analysis (which revises cost-efficiency of operations performed by specific units of the government). However, the potential bottleneck of such functional review is its excessive emphasis on the inventory of current function rather than on the critical and broad assessment, revision and redefinition of these functions.<sup>14</sup> Undeniably, the inventory of government's functions may provide the reformers with a clear picture of the existing structure of the government. However, such an approach might fail to answer the pivotal question of the functional review, namely, what functions the government should perform to best serve public interests. In particular, a functional review conducted by each ministry in isolation fails to detect many serious functional flaws including the duplication of functions and execution of non-essential and non-core operations.

Second, the proposed inventory of functions by design requires a clear definition of the missions of various state agencies in Ukraine (see Box 2). However, available sources of this definition<sup>15</sup> may fail to serve as a solid foundation of the transparent and duplication-free structure of functions performed by state institutions. The Constitution and Laws of Ukraine offers only a very general outline of the authority and responsibility of various state agencies, while supporting legislation represents a vast and complex system of secondary laws, decrees, regulations and procedures. Obviously, an effective functional review should evolve along the long-term strategic concept (for example, the program of the Cabinet of Ministers) that proposes a coherent vision of the government's role in the economy as well as defines a

<sup>12</sup> Department of the Civil Service of Ukraine, Order No. 189, June 29<sup>th</sup> 2005

<sup>13</sup> However, insufficient openness of the Ukrainian public institutions may restrict the participation of external experts in the working groups conducting functional review. As a result, the lack of expertise and experience may considerably jeopardize the quality of the functional review if this review is exclusively performed by in-house personnel.

<sup>14</sup> The Ukrainian initiatives on the functional review still lack the entire depth of successful functional reviews implemented by developed countries (for example, Canada, New Zealand and Australia) as well as developing and transition countries.

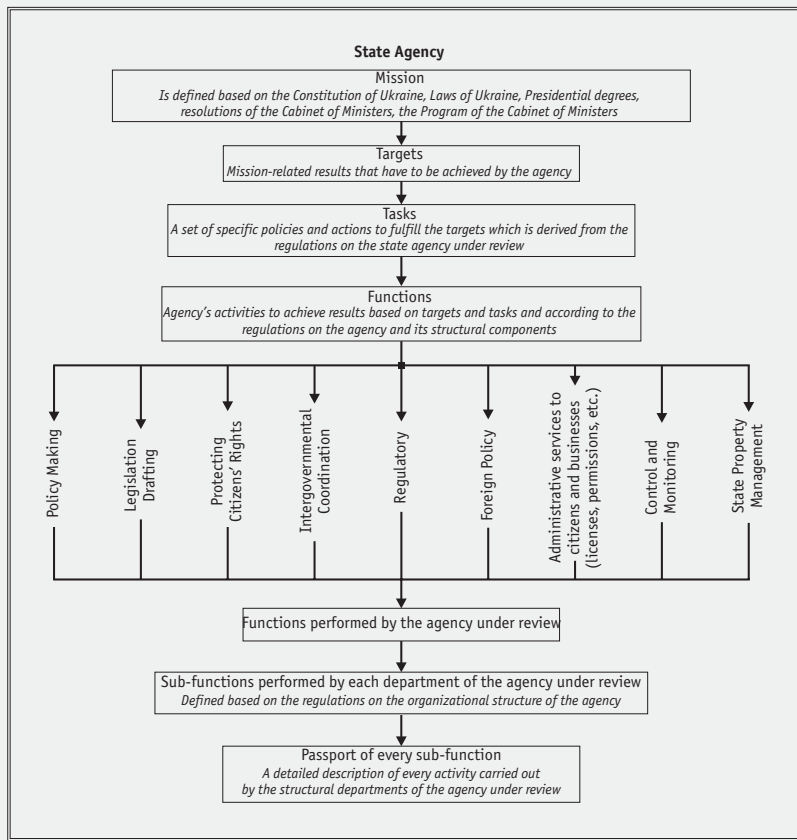
<sup>15</sup> The Ukrainian initiatives on the functional review still lack the entire depth of successful functional reviews implemented by developed countries (for example, Canada, New Zealand and Australia) as well as developing and transition countries.

**Box 2: Classification of Government's Functions**

According to the developed methodology, all functions of the state agencies in Ukraine are supposed to be classified by nine types: (1) policy making, (2) legislation drafting, (3) protecting public interests, (4) intergovernmental cooperation, (5) regulation, (6) foreign policy, (7) administrative services to population and businesses, (8) control and monitoring, and (9) state property management. The Department of the Civil Service of Ukraine has also developed a detailed scheme to organize such a review and listed a set of optimization options, including:

- *liquidation* — cease to perform the function;
- *decentralization* — transfer the function to a lower level government;
- *modification* — adjust the function to the new requirements of legislation;
- *rationalization* — scale down or combine with another function;
- *privatization* — transfer the function to the private sector.

**Figure 2.2: Proposed Classification of Functions**



set of mechanisms, enabling policy implementation and execution. Such a program has not yet been approved by the government. Moreover, largely due to the absence of a common vision on the functions of the state, the Ukrainian government is notorious for its inability to come up with any medium or long-term strategy.<sup>16</sup> Therefore, any effort to structure state administration based on the laws currently in force will at most lead to the mere justification of the currently performed functions by the bureaucracy of state agencies under review, especially with the strong instinctive motivation of insiders to preserve as many functions as possible. Furthermore, Ukrainian legislation per se is too complex, cumbersome and inconsistent to generate a transparent and logical system of functions within state administration.<sup>17</sup>

Third, though the instructions on functional review are rather extensive, the methodology is not adequately designed to encourage a radical review of the role of the government. In particular, the scheme is flexible enough to bypass many efficiency and public interest tests and keep the function within the state agency without significant transformations of the operations under review. Furthermore, the principle flaw of the proposed scheme is its weak reliance on private sector involvement in the delivery of public services. Hence, it is unlikely that the results of this functional review can be effectively applied to scale down the public sector and facilitate public sector partnership with private contractors. The lack of properly functioning

<sup>16</sup> In addition, Ukraine is famous for its short-lived governments as the country has been run by fifteen different governments since 1990. Although it is reasonable to assume that the core administrative bureaucracy remained in place, the government obviously lacked strong leadership to launch a meaningful public administration reform.

<sup>17</sup> For example, the Ukrainian government has two agencies that regulate financial markets: the State Commission for Regulation of Financial Services Markets of Ukraine (SCRFS) and the State Commission for Securities and Stock Market of Ukraine (SCSS). Although, SCRFS supervises a broader segment of financial services, the provisions on the missions of both commissions include similar items, which leads to substantial overlapping of functions and responsibilities.

mechanisms of private-public partnerships is an additional drawback that seriously narrows the range of applications of the functional review. Even if a specific optimization option is selected, its implementation will be delayed due to the unavailability of transparent and accountable procedures to competitively contract out public services to the private sector. Such key processes of service delivery as competitive price and tariff setting, adherence to quality standards and maintenance of fair and inclusive public access to outsourced services are still poorly developed and regulated.

Finally, many of the state agencies are not ready to administer functional reviews. Working groups on the functional review have not yet been formed by all central executive authorities, while the coordination council on this review lacks the initiative and authority to speed up and monitor the process. Although, the methodological and advisory assistance for the functional review is provided by the Center for Support of Civil Service Institutional Development (created in 2004 as a state agency under the supervision of Main Department of Civil Service in Ukraine (MDSSU)), the release of the official methodology on the functional review was delayed until January 2007, which implies that the role and capacity of MDSSU to administer functional review is rather nominal. As a result, this functional review suffers from several alarming flaws, including (i) weak centralized supervision, (ii) inadequate speed of the process, (iii) excessive reliance on rigid and complex categories to classify functions of the government rather than redefine them, (iv) Ukrainian laws establish only imprecise boundaries of authority and responsibility of various state agencies as well as different levels of the government. Hence, this initiative in the end may be reduced to an inventory of functions performed by state agencies with no direct and significant impact on the efficiency of public administration.

In conclusion, it is necessary to highlight major weaknesses of the proposed functional review that have to be resolved to proceed with effective revision of government's functions:

- The proposed functional review is unlikely to lead to a critical evaluation of functions performed by the government. The phase of the review during which a role of the specific state agency is defined based on pragmatic economic and social considerations is virtually absent (as it requires a formal agreement on Ukraine's long-term developmental strategy, which is still missing). Moreover, the functions performed by the agencies under review are to be determined based on the legislation currently in force. However, due to its complexity and internal contradictions, the outcomes of such a functional review will be of limited value. Such an approach is rather inconsistent with the general logic of any functional review, which relies on clear and proper a priori definition of the role of the government. In addition, there are no clear and feasible targets (for example, an objective to cut budget expenditure by a certain percentage) on the back of which this functional review can be carried out.
- The overall methodology of the functional review is poorly developed. A principle weakness is the absence of any established measurable performance criteria. As a result, the only obvious purpose of this functional review is to systemize functions currently performed by the government. However, it would be more practical to conduct this functional review with an explicit objective to strengthen the policy making and policy implementation capacity of the government (for example, the capacity to pass high quality regulations within a limited period of time).
- So far, the government has failed to allocate strong leadership and commitment to public administration reform in general and to the functional review in particular. The institutional and resource capacity to execute this functional review has not been properly strengthened. The level of collaboration between the coordination council on the functional review, DCSU and participating government agencies is far from being optimal. Furthermore, the government officials frequently lack skills, vision, competence, experience and motivation to launch and carry out this review.

### 2.3. Policy Recommendations for Ukraine

Functional review of the government is a cornerstone of the institutional development of public administration in Ukraine. The proposed horizontal and vertical functional review should provide the government of Ukraine with feasible solutions to key public administration issues, including:

- Clear definitions of functions that have to be performed by various public institutions without overlapping and duplication.
- Optimization of functions fulfilled by different divisions within one government agency.
- Adequacy of the newly defined functions to the country's policy priorities and developmental objectives.
- Developing the capacity to control execution of functions assigned to all government agencies and maintain productive cooperation with the private sector.
- Defining a degree of functional decentralization between central and local governments.
- Degree of private sector involvement in the process of public service delivery.
- Long-term affordability of efficient public service delivery.

**Conducting an efficient functional review in Ukraine should include the following measures:**

- **Formulation** by the government of a clear vision of state functions in the society, which should be done through **adopting a Concept on the "Role of the State in Ensuring High Living Standards in Ukraine"**. This effort should rely on **strong leadership and broad participation of all stakeholders, experience, and openness** to new technologies and managerial approaches to public administration.
- **Establishing** under the Prime Minister's office a permanent and politically neutral and unbiased **Executive Group** responsible for the execution of public administration reform and with full powers to carry out the reform. It is fundamental to organize the working group under the highest level of authority, since it would provide this group with the required "mandate" to manage the whole process within the government agencies in order to ensure a high quality of implementation of public administration reform. It should also eliminate possible resistance to reforms from the side of the existing state agencies. This approach extends beyond a mere short-term solution and establishes an institutional framework that ensures effective implementation of the functional review.
- **Preparation** by the working group of a special **questionnaire** with a limited number of questions, which would be **sent to all government departments and agencies**. All recipients of the questionnaire will be instructed to review each of their functions against six criteria: (1) Is a public interest involved in this particular function? (2) Is this function something that the central government should be doing? (3) Can this be transferred to the provinces? (4) Could this be done by the private sector? (5) Can this be made more efficient? How? (6) Is this affordable? The obtained results will be summarized by the working group and accompanied by the concrete **Functional Restructuring Recommendations**, which should be presented to the Cabinet of Ministers.
- Considering recommendations and comments of the Cabinet of Ministers working group should prepare a **detailed plan of reorganization** of public service in Ukraine, which should include the list of the proposed government agencies with the execution functions retained for the government.



## 3. Operational Review of Government

### 3.1. International Experience

Increasing organizational efficiency is the main goal of the operational review of public institutions. The prerequisite for conducting an operational review is a completed functional review. Therefore, it examines only those functions that were retained within the authority of the government. This review seeks to clarify the roles, responsibilities and accountability of all line ministries and agencies as well as senior public servants. This goal is reached through developing new effective organizational structures and introduction of an effective mechanism capable of delivering high quality public services to the population. The final outcome of the operational review should be a new organizational structure of the executive branch in which each government agency should be assigned certain functions without any duplication.

Typically, the operational review concentrates on the following key issues:

- Who is accountable for what and to whom;
- How well responsibilities and accountabilities are assigned to each government department and public servant and are understood by them;
- Which set of measures should be implemented to strengthen/optimize the operations of the line ministries/agencies and their divisions.

The operational review sets the basis for a longer-term reform of core public sector management policies and practices. This review is a broad consultation process, inside and outside the government, which requires the active assistance and participation of various profile think tanks and policy groups.

The international experience of conducting operational reviews suggests that this review should examine all government expenditures, the system of government operations and based on these findings should identify opportunities for improving the system of governance.

Typically, operational reviews are conducted in the following areas:

- Public sector compensation and comparability;
- Procurement system and mechanism of contracting;
- Quality of administrative services;
- Quality of professional services;
- Use of IT capacities in the decision making process and operations of the state agency;
- Quality of infrastructure of public service delivery.

Operational review should ensure significant savings of administrative costs associated with the existing in the country system of public governance. Furthermore, the recovered resources might be used and re-invested in other state priorities such as healthcare, education, communities/local development, assistance to poor and disabled.

The outcome of the operational review has major implications for the entire system of public services delivery. Therefore, it is crucial that this outcome ensures the best possible way of the provision of high quality public services/goods as well as sufficient delivery of such services. The new structural arrangements created during the operational review should be consistent with the cultural traditions existing in the country, which can maximize operational improvements in the delivery of public services and introduce improved performance management with appropriate incentives within the country's public sector. The costs of implementing the structural reforms that emerge from the operational review should be offset by the efficiency savings, of which a significant share is generated through the reduction of the regulatory burden on businesses.

While restructuring the government agencies, special emphasis should be placed on local governments, which should play a key role in the delivery of local services, in providing strong civic leadership and in community planning. Any replications and duplications of resources are unwarranted if there is significant potential to achieve greater economy of scale and scope in public procurement and delivery of services. The international experience of operational reviews suggests that there should be a greater role for local governments in providing public services, since local authorities can produce better value for the same (or even lower) amount of money.

### 3.2. Policy Recommendations for Ukraine

The main outcome of the operational review of state agencies in Ukraine should be more efficient utilization and allocation of public funds. The key design features of such a mechanism should include:

- long-term financial viability of the administrative system;
- accountability, integrity and superior governance of public administration;
- ability to draft and implement economic and social policies that solve the country's developmental challenges;
- capacity to meet the citizens' needs, protect their social well-being and achieve sustainable improvement of service delivery;
- better access for consumers to public services through the modernization of public infrastructure, simplification of service delivery, integration of service delivery channels into one-stop centers and paperwork and red tape reduction;
- improved coverage and quality by means of alternative service delivery processes, enchanted competition in the provision of public services and active involvement of the private sector and non-government organizations in service delivery.

**To conduct an efficient operational review the Ukrainian government should implement the following measures:**

- **Review *modus operandi*** of each public sector institution and prepare recommendations on optimization of their operational systems
- **Review** compensation of government employees and **conduct comparative analysis** of their efficiency with approximation to private sector.
- Based on the comparative analysis, **develop methodology on compensation of government employees** based on the evaluation of their achievements. Implement this methodology into government practice.
- To restrict any possible abuses or corrupt practices from government agencies, introduce a high level of **transparency** through employing capacities of IT-government.
- By issuing a special law On Information Disclosure, government should clearly **define** all types of information of national security. All **non-national security information should be freely available to the public** through introduction of IT government and precise procedures on obtaining information from each government agency by citizens.
- To **avoid corrupt practices** in government **procurement**, a western-style Law on Procurement should be adopted

## 4. Civil Service Reform

### 4.1. Current State of Civil Service in Ukraine

Over the last several years, the effectiveness of Ukrainian civil service has come under close scrutiny. In particular, government institutions and agencies have been increasingly required to ensure provision of high quality public services and to serve more as a partner to Ukraine's private sector rather than a competitor. Since 1993, when the Law "On State Civil Service" was adopted and later supplemented by subsequent secondary legislation, the existing system of civil service in Ukraine was under close public scrutiny as it was identified as one of the key institutional components of public administration that had to be significantly modernized.

#### *Trends in Civil Service Employment*

Quantitatively, the current government machinery of Ukraine is well equipped with personnel. Moreover, over the last decade, the total number of civil servants increased by almost 50% and reached 276,559 employees at the beginning of 2008, which is about 0.6% of the total population or 1.32% of the employed labor force. Although this indicator is only marginally higher than in other transition economies, the posted rate of growth was rather significant.

Starting in 1993, Ukraine's civil service has been evolving towards strengthened power of the central government with relatively low development of regional power. Due to such center-oriented features of its institutional organization, civil service in Ukraine was initially developed at the national level. The regional (i.e., oblast) level civil service remained rather weak and unmodernized. Moreover, despite the fact that during the last couple of years, local level institutions received considerable credentials from the central government<sup>18</sup>, they still experience a significant deficit in resources and suffer from the existing irregularities in the distribution of power between the center and the regions.

**Table 4.1: Breakdown of Civil Servants by Employee in 2007**

Place of Employment	People employed
Civil servants employed by the Presidential Secretariat, Office of the Parliament (excluding elected), Secretariat of the Cabinet of Ministries	9,110
Office of the central executive power agencies (total)	13,076
Local units of ministries and other Central Executive Power Agencies (CEPA)	145,726
Republic of Crimea government authorities	593
Local state administrations	73,243
Other, including civil servants in the Ministry of Defense, the Ministry of the Interior, the State Security Service, the Administration of the State Frontier Service	34,811
Total	276,559

Source: Department of Civil Service of Ukraine

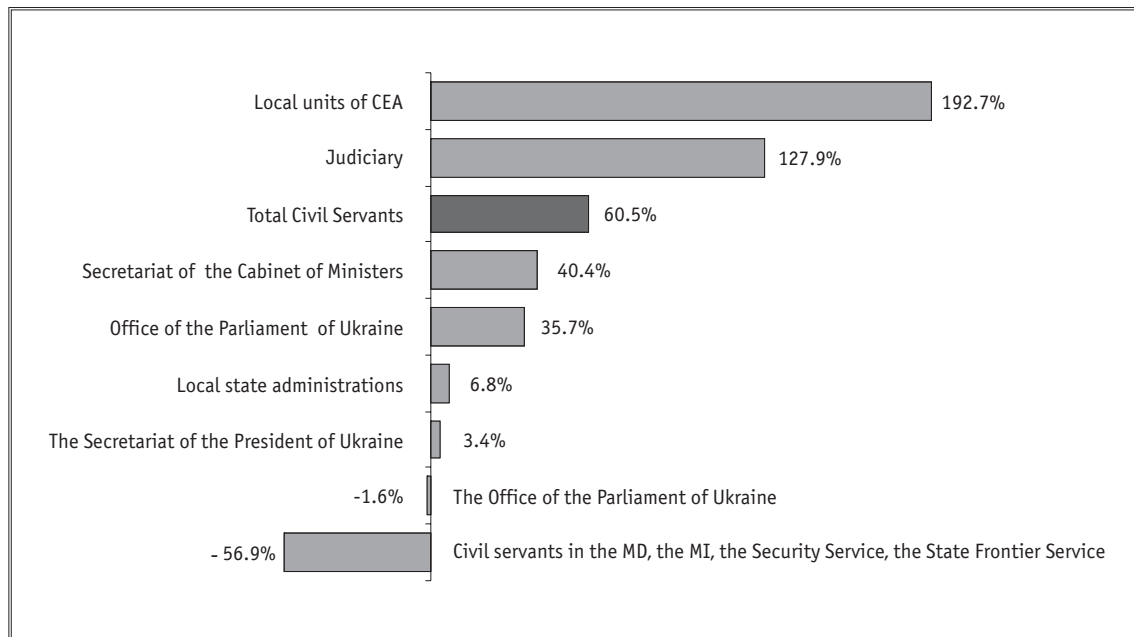
The existing distribution of civil servants between the center and the regions reflects the allocation of powers at the central and sub-national levels. The regional composition of civil servants implies that the real "power" is concentrated in the center but not at the local level. Although a significant portion of central government civil servants are physically located in the regions, they still operate under the central agencies' authority. As a result, their accountability to local communities and local governments is rather weak. Thus, this group of civil servants should not be included in the group of civil servants employed

<sup>18</sup> See for more details Law on Local Self-governance, Budget Code, and Law on Local State Administrations.

locally. Based on such distribution of civil servants between the two categories, it can be estimated that the share of "purely local civil servants" in the total quantity of country's civil servant was 26.4% in 2007. At the same time, local/regional offices of the central executive power, which can not be considered purely local institutions, employed almost 53% of the total number of civil servants.

The expansion of the central government bureaucracy throughout the country posted a substantially higher rate of growth compared to the growth of sub-national government bureaucracy. Although the number of civil servants "physically located" in the regions increased significantly in 1995–2007, its qualitative composition suggests that the primary aim of this process was to strengthen the central power institutions rather than local self-governance. In 1995–2007, the period growth rate in the number of civil servants at the local level did not exceed 1%, while the number of civil servants employed by the local units of ministries and other central executive power agencies located in the regions surged by 193%.<sup>19</sup> Moreover, at a purely central level, agencies such as the Presidential Secretariat, Office of the Parliament (excluding elected positions), and the Secretariat of the Cabinet of Ministries demonstrated high rates of growth as well. Civil servant employment surged by nearly 40% during this period.

**Figure 4.1: The Growth of Employment in the Ukrainian Civil Service during 1995–2007**



Source: Department of Civil Service of Ukraine

In the contemporary history of Ukraine, the most significant annual increase in the number of civil servant was first registered in 1996 when their total number increased by 9.4%. This expansion was mainly due to (i) a 31% increase in the number of personnel employed by the local units of ministries and other central executive power agencies and (ii) a 23% increase in the number of personnel employed by the local state administrations. Although the number of civil servants continued to follow an upward trend after the significant hike in 1996, the rate of growth was much slower and its annual average did not exceed 0.5%. However, this trend of steady moderate growth became steeper in 2001 and 2002, when the number

<sup>19</sup> With the intention of restricting the growth of civil servant employment, the Cabinet of Ministers of Ukraine issued a decree No. 403 in February 2000, which established upper bounds on the number of civil servants that can be employed by the central state agencies (including pension fund of Ukraine, customs and tax administrations) and their regional subsidiaries. However, after numerous revisions, these limits were significantly raised: (i) for the central executive authorities from 11,573 in February 2000 to 17,349 at the end of 2007 or by about 50% and (ii) for local subsidiaries of the central state agencies from 169,151 in February 2000 to 207,420 at the end of 2007 or by 22.6%.

of civil servants picked up by 8.6% each year. The second historical rise was driven by (i) an almost doubling of the number of civil servants employed by the agencies supporting execution of authority of the President, Parliament and the Cabinet of Ministers, and (ii) an almost 60% surge in the number of civil servants employed by the CEA. In 2003, this upward trend was not reversed, although the rate of growth started to decelerate, reaching 2.2% in 2005. As before, this growth was registered on the back of the significant increase in the number of civil servants employed by the center and not by the regions. Moreover, in 2006 and 2007 the number of civil servants employed by local units of ministries and other CEA tended to grow as well.

Strengthening of the center authority continued in Ukraine despite the fact that responsibilities of local governments were gradually increased and there was a need to reinforce the power of the regions. For instance, local authorities became more responsible for providing the population with a wide range of social security services including education, public health, housing and utilities.

**Table 4.2: Change in the Number of Civil Servants Employed by Type of Employee**

Place of employment	2001	2002	2003	2004	2005	2006	2007
<b>Total number of civil servants</b>	208,992	226,985	240,528	251,471	257,112	265,703	276,559
The Secretariat of the President of Ukraine	398	508	538	530	497	530	553
The Office of the Parliament of Ukraine	881	942	958	1,022	1,051	1,069	1,060
The Secretariat of the Cabinet of Ministers of Ukraine	649	655	728	887	935	1,046	1,007
State agencies of Ukraine	11,535	12,227	12,940	13,402	13,871	12,400	13,076
Office of the central executive power agencies (total)	6,900	6,988	7,175	7,429	8,585	6,673	7,065
<i>Ministries</i>	1,431	1,522	1,548	1,526	2,430	2,817	3,275
<i>State committees and central executive power agencies (CEPA)</i>	2,596	3,142	3,218	2,841	1,777	1,885	1,817
<i>CEPA with special status</i>	2,039	2,097	2,547	3,132	3,509	3,842	4,194
Local units of ministries and other CEPA	99,644	110,092	117,359	120,145	124,843	139,019	145,726
Staff of ministries and committees of the AR of Crimea	56	44	54	74	76	145	472
Staff of the Parliament of the AR of Crimea	153	160	177	162	161	118	121
Local state administrations (total)	64,651	64,716	65,131	68,626	68,995	70,226	73,243
<i>regional, Kyiv, Sevastopol state administrations</i>	18,374	18,521	18,698	19,152	18,530	19,081	19,613
<i>district state administrations</i>	46,277	46,195	46,433	49,474	50,465	51,145	53,630
Judicial power agencies and Prosecutor's Office (exc. certified employees)	13,622	18,493	23,313	27,276	27,202	22,837	22,345
Civil servants in the Ministry of Defense, the Ministry of the Interior, the State Security Service, the Administration of the State Frontier Service	9,272	10,036	10,106	10,019	9,988	10,574	11,284

Source: Department of the Civil Service of Ukraine

### Performance Management

The main goal justifying the introduction of performance management in the country's civil service is to increase the level of efficiency in delivering government services to the general public. With this purpose, many governments across the world introduced different systems of performance management of day-to-day operations for their civil servants (e.g., UK, USA, Australia, New Zealand, Latvia). However, the first attempts initiated in Ukraine on the introduction of such systems were undertaken only recently and in the form of "pilot projects" that are still in the process of implementation.<sup>20</sup> Therefore, this particular experience will be available for analysis later on.

<sup>20</sup> The donors' financed projects on reform of the system of civil service within the Ukrainian Ministry of Foreign Affairs.

The Law of Ukraine "On State Civil Service" adopted in December 1993 defines civil servants as "professional occupation of persons holding positions in public bodies and their administration for the purpose of practical performance of tasks and functions of the state for wages received from government funds".<sup>21</sup> However, this law includes only very general statements on the criteria for evaluating the performance of the government machinery as well as performance of individual civil servants. Therefore, in reality, performance management as an element of effective general management of Ukraine's civil service is poorly developed.

Realizing the importance of a well functioning civil service, the Ukrainian Cabinet of Ministers issued Resolution No. 2092 in April 1994, which created a central executive power agencies with a special status called the Main Department of the Civil Service of Ukraine, in order to develop a management system able to deal with the country's civil service. The Resolution envisaged that the main responsibilities of the Department should include:

- Ensuring of realization of main guidelines of human resources policy in the sphere of public services at both central and local levels;
- Ensuring functional management of the country's public services;
- Elaboration of current needs and long-term forecasts in personnel by all state agencies;
- Developing measures aiming to increase the effectiveness of public services and monitoring their practical implementation;
- Organization of education and professional training of civil servants;
- Supporting academic research related to the country's civil service.

In order to ensure the efficiency and independence of civil servants, Ukrainian authorities had to develop motivational mechanisms with the capacity to supply government machinery with highly effective and skilled labor. This issue was reflected in the Law "On State Civil Service", which declares that the remuneration for work carried out by civil servants should (i) guarantee sufficient material conditions for the independent performance of duties, (ii) promote staffing of state agencies with competent and experienced personnel and (iii) stimulate their faithful and creative work. The income of civil servants was defined as a sum of salary, bonuses, additional payments for rank, and bonuses for the duration of employment in the civil service. The bonus for the duration of employment in civil service was supposed to be paid to state servants every month and counted as a percentage of the official salary taking into consideration the bonus for the rank and depending on the length of completing duties.<sup>22</sup> Ukrainian legislation states that civil servants should have bonuses for high working achievements and performance as well as material assistance to settle social and personal issues. Moreover, shortening of budgetary appropriations cannot be a basis for the reduction of official salaries, bonuses and financing of other guarantees, privileges and compensations envisaged by the law.

Although it was well declared, in practice the level of cumulative income received by civil servants does not motivate them enough to provide the public with high quality services. If compared with the average salary in the economy (UAH 1 351 in 2007), the wages received by civil servants are about 46% higher than the average market level. However, taking into consideration that a significant portion of civil jobs are located in Kiev, where the average salary in 2007 was UAH 2 300, civil servants received almost 14% less than the private sector average. The situation when public servants are underpaid opens a set of serious questions

<sup>21</sup> The Parliament of Ukraine, the Law of Ukraine "On State Civil Service", No. 3723-XII, December 1993.

<sup>22</sup> More than 3 years — 10%, more than 5 years — 15%, more than 10 years — 20%, more than 15 years — 25%, more than 20 years — 30%, more than 25 years — 40%.

including (i) whether civil servants conduct their duties faithfully under such conditions; (ii) whether civil servants are able to refrain from breaching anti-corruption legislation or from illegal connections with business; (iii) whether highly professional individuals will be willing to join the civil service.

The professional level of civil servants is reflected in their level of education. Admittedly, in 2007, 78.4% of civil servants had a high level of education (i.e., master's degree).<sup>23</sup> However, civil service careers remain unattractive in Ukraine for many reasons, especially for the young people who prefer a business career with its self-realization possibilities and high salaries rather than civil service employment with a very strict hierarchy and subordination. Although substantial efforts were undertaken by the government to supply civil service with professionals trained in public administration issues, during 2007 only 0.14% of the current civil servants graduated from the leading profile institution — National Academy of Public Administration under the President of Ukraine with a Master's degree in Public Administration. Therefore, the professional quality of civil servants improves very slowly, which negatively affects the entire system of public administration in Ukraine.

#### 4.2. Policy Recommendations for Ukraine

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Civil service reform should aim to upgrade the quality of government staff, including a clear certification system for personnel hiring, payment and advancement linked to good performance and dismissal rules for civil servants. It would include the following:

- **Reduce** the number of civil servants while increasing the salaries of the remaining staff.
- To quickly **improve** middle-level management, the merits of a Senior Executive Corps, modeled after the US Government's SES or the New Zealand's Senior Executive Service, should be considered as a short term solution; under this approach, job security is given up in return for higher salaries.
- **Introduce** a system of incentives for civil servants to encourage sound job performance, hiring, promotion and separation of employees.
- To **motivate** job performance, a part of the employee compensation should be linked to the achievement of measurable objectives.
- **Strengthen** the involvement of civil servants in setting objectives and work programs of their agencies through the capacity of non-monetary incentives, in particular, the perceived stature and professionalism of government employment.
- **Delegate** more authority/power to middle level managers to empower them to act effectively.
- **Introduce** effective training programs in order to increase civil servants' qualifications to EU standards.
- **Adopt** legal regulations and policy statements that deal with problematic issues in the management of enterprises in which the state is still a shareholder.

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<sup>23</sup> Department of the Civil Service of Ukraine

## 5. Distribution of Functions Between Central and Local Governments

Obviously, the distribution of functions across various levels of the Ukrainian government is a matter of the broad research program that extends far beyond the subject of our paper. However, public administration reform can not be analyzed in isolation from the decentralization issues. Good public governance relies on the appropriate balance of functions and roles within the central government as well as on the optimal allocation of responsibilities between the central and local authorities. The distribution of functions between central and local authorities is important at least for two considerations. First, sub-national governments certainly enjoy a considerable advantage of being in the immediate proximity to final consumers of public goods and services. Hence, they are best equipped with knowledge and expertise of how to use scanty public resources to address the pressing social and economic needs of local communities. Second, a transfer of functions from the central government to local authorities is an essential component of any good functional review. This transfer eliminates many functional overlaps and improves cost efficiency of the public sector. For this reason, decentralization should be treated as a feasible and effective option to scale down the central government and strengthen overall fiscal and budget discipline. Thus, the principle purpose of this section is to draw readers' attention to the importance of decentralization in public administration reform.

### 5.1. International Experience

Decentralization is a key component of public administration reform and implies a transfer of authority, administration, functions and responsibilities from the central government to local authorities or non-government organizations. The principle rationale for decentralization is enclosed in the assumption that local governments, due to their immediate proximity to citizens, possess better knowledge of citizens' needs and preferences. Consequently, they can deliver vital public services more efficiently than the central government. As a result, decentralization can enhance the effectiveness of public administration and promote good governance through its positive impact on social inclusion and representation of citizens' interests in public policy making.

Highly centralized governments are frequently detached from the interests of regional communities. Such local communities have negligible impact on policy making while centralized state institutions enjoy weak accountability for the provision of public services, which leads to spreading poverty and rising social inequality. Decentralization is an effective remedy to these problems since it allows local authorities to exercise their knowledge advantages on the rational use of regional public resources for the provision of basic public services to local communities. At the same time, the success of decentralization programs relies on the adequate design of inter-governmental relationships as well as on the properly developed capacity of the local governments to deliver public services.

Developing and transition countries have probed a wide range of decentralization models. The results of these initiatives were rather mixed and frequently depended on country-specific parameters. In general, decentralization introduced various patterns of the redistribution of political (*devolution*) and administrative (*de-concentration*) powers between the central and local governments. However, a frequent failure to match decentralization of functions with the allocation of resources resulted in limited gains from the higher independence of local authorities.<sup>24</sup> A situation when *de jure* local governments were given extensive independence and responsibility to deliver public services to local communities, while *de facto*

<sup>24</sup> Shah, Anwar (2004). "Fiscal Decentralization in Transition Economies and Developing Countries: Progress, Problems and the Promise." Policy Research Working Paper Series, No. 3282, World Bank



enjoyed limited autonomy with respect to administration and budget resources was a typical pathology of unsuccessful decentralization. An insufficient degree of budget revenue autonomy at the regional level and a heavy reliance on subsidies and transfers from the state budget are the most eloquent evidence that decentralization has not yielded expected results.

The institutional design of local governments is of key importance to capture maximum efficiency gains from decentralization. *Symmetric duplication* of the administrative structures of the central government in the regions proved to be a highly inefficient approach to organize local self-governance as it considerably inflated the size of public administration and did not allow for an efficient relocation of functions from the central to sub-national governments.<sup>25</sup> On the contrary, *asymmetric* approaches, assigning functions and responsibilities to local authorities that can be best performed by sub-national governments, yielded excellent results. In essence, this method assumes that local governments accept the responsibility for the provision of basic social services (e.g., healthcare, public housing, education and social care), while the central government retains functions that require nationwide coordination (for example, tax compliance and law enforcement, national defense and foreign policy). However, it is crucial to ensure that the local authorities are empowered to collect budget revenues that are sufficient to deliver public services in the required amount and under established quality standards. Unless the central government channels its efforts and resources to strengthen the revenue capacity of lower level governments, the outcomes of the decentralization reform will be of limited magnitude.

A balance between the responsibilities and authority of the local and central governments has been constantly changing across the world political systems. OECD countries, even those where governments traditionally tended to maintain a high degree of centralization, have consistently opted for higher autonomy of the regional authorities. Furthermore, decentralization frequently followed functional reviews of the government as an optimal solution to scale down the central state apparatus and improve cost efficiency of public services delivery. Although developing countries did not unanimously follow the same trend, their governments have pursued various decentralization reforms to improve the welfare of local communities. The experience of these decentralization initiatives can be synthesized into the following key lessons:

- The functional review of the government must be conducted at both the local and central levels. It is unreasonable to expect that functions stripped off the central government can be productively performed by the local authorities if a comprehensive assessment of the functional capacity of local governments is absent.
- Obviously, any function performed by the central government must pass the *public interest test*. In addition, the government must ensure that it delivers the best value for every unit of public funds spent. Therefore, decentralization can only be justified if it improves the efficiency of the public sector along these two dimensions.
- Enhanced accountability and citizen participation in policy making are priority targets that have to be achieved. Evidently, a transfer of functions to local governments effectively remedies insufficient representation of the interests of local communities by the central government. However, since any reallocation of funds, authority and responsibilities entails a conflict of interest of various political groups, it is imperative to gain nationwide support on decentralization reform. Otherwise, productive cooperation and control between the different levels of government will not be sustained.
- The structure of the local governments should be formed based on the asymmetric distribution of functions, which implies that local authorities are organized and treated according to their

<sup>25</sup> United Nations (2007). "Public Administration and Democratic Governance: Governments Serving Citizens."

revenue potential, local communities' needs for public services, conditions of local infrastructure and facilities, and economic and social development of the regions. Obviously, these considerations imply that the functions and authority of local governments must be tailored according to the demands and resources of local communities.

- A comprehensive reform of the civil service is necessary to adjust the employment of civil servants both at the local and central levels through (a) the elimination of excessive regional administrative units of the central government, which frequently duplicate the functions of the local authorities, and (b) liquidation of the central state agencies that perform functions which can be and should be transferred to the local governments.
- The revenue and expenditure functions of local authorities should be matched to improve the accountability of service delivery at the regional level. The local governments can hardly be made accountable for the functions assigned to them by the central government if these responsibilities are not backed by needed budget revenues. If there is a weak link between the functions of sub-national governments and their financial resources, the appeal of local communities for better service delivery cannot be adequately addressed.
- Fiscal discipline and fairness of local and central governments must be strengthened. Essentially, local and central governments should not compete for preferential access to private financial sector or central bank loans. Decentralization must result in an optimal balance between the distribution of functions and resources across all levels of government.
- The local governments face tighter financial constraints to invest in local public infrastructure projects. Hence, the central government should develop effective measures of financial assistance and grants (for example, using its advantages to borrow at the international capital markets at lower interest rates) to ensure balanced economic and social development of the regions.
- The central government must use its size and influence to accelerate country-wide promotion of the rule of law, economic liberalization and competitive markets. These institutional improvements are critical to facilitate private sector development at the local level. Growing private businesses will create jobs and pay more taxes, strengthening the revenue capacity of the sub-national governments. Local governments, underpinned by higher and more stable tax revenues, will be able to deliver vital social services to local communities on a sustainable basis.

## 5.2. Decentralization and Local Self-Governance in Ukraine

Decentralization reform has been a long standing priority of the Ukrainian government and was explicitly formalized in the Constitution of Ukraine as well as in a number of concepts on the development of local self-governance.<sup>26</sup> As a result, Ukrainian legislation on sub-national governments is now relatively well formalized. Local governments are regulated by two principle laws: the *Law on the Local Self-Governance*, which defines the scope of authority and responsibilities of sub-national governments, and the *Budget Code*, which establishes procedures for the budgeting process and intergovernmental financial relations. Local governments are composed of representative councils, which are elected through direct voting by the population that resides in corresponding territories. The atomic unit of local self-governance is formed by village (county) councils representing small local communities. District and oblast councils compose upper level branches of the representative local governments with the responsibility to address issues of district and oblast significance. Every council creates an executive committee, which drafts and implements local budgets and programs of economic and social development. Finally, oblast and district

<sup>26</sup> For example, presidential decrees No. 341/2001 on "the Concept of the State Regional Policy" and No. 749/2001 on "the Program of State Support for Local Self-Governance Development in Ukraine."

local state administrations establish a regional network of the central executive power, which is structured and supervised by the central executive authorities.

Overall, laws on local self-governance, especially the Budget Code, establish favorable legal conditions for the development of independent and strong sub-national governments. However, many provisions regulating the revenue capacity of local budgets still insufficiently account for the current territorial-administrative division of Ukraine.<sup>27</sup> Unbalanced economic and social infrastructure of different regions is the principle weakness of this administrative division. Furthermore, small sizes as well as low population density of many local communities considerably limit resources available to local governments to finance a minimum set of basic public services. This issue is particularly pressing for small rural communities.

Alas, a striking divergence in economic performance of the regions and local communities exacts a serious toll on the development of strong local self-governance in Ukraine. First, the capacity of the local government to collect fiscal revenues is conditional on the economic development of the regions. Since the largest share of fiscal revenues of local budgets in Ukraine comes from the personal income tax, the self-financing capacity of the local governments is particularly sensitive to distribution patterns and dynamics of household incomes. Although, the cross-regional difference in nominal wages is relatively moderate as compared to the variation in GDP per capita, it nevertheless has direct implications for personal income tax collection by local authorities. Second, standards of living in the regions with weak economic performance tend to be lower. As a result, these regions rely heavily on the active involvement of sub-national governments. However, local governments of less developed regions frequently do not have sufficient resources to finance social programs at an adequate level. As a result, their dependence on subsidies and transfers from the central budget has been steadily growing.

Public administration systems with strong and financially autonomous sub-national governments should distribute a large fraction of public resources through local budgets. While *de jure* Ukraine has been moving toward higher decentralization, the flow of funds between the central and local governments indicates that the actual performance of these decentralization initiatives was rather mixed. In particular, the ratio of local budget expenditures to GDP has been increasing since 2001, which may reflect the adoption of the Budget Code in 2001. However, the ratio of local budget revenues (excluding transfers from the state budget) to GDP was on a downward trend, approaching only 8% in 2007. At the same time, over the last ten years, both the ratio of state budget expenditures (net of transfers) to GDP and the ratio of state budget revenues to GDP have been steadily growing. These developments reveal a tendency toward more centralized distribution of budget funds in Ukraine. A similar conclusion is supported by the low share of local budgets' own revenues in the consolidated budget revenues. Apparently, the capacity of local authorities to raise budget revenues independently is still rather weak. The structure of total revenues of the local budgets (including transfers from the state budget) is an eloquent confirmation of insufficient financial autonomy of local self-governance. While transfers from the state budget to local budgets constituted only 18.3% of local budget revenues in 1998, this number swelled to 45% in 2007.

These developments may have been triggered by the shifting composition of consolidated budget expenditures as more funds are now spent through local budgets due to the centralized assignment of social responsibilities to local governments. However, the share of local budgets' expenditures in the

<sup>27</sup> Although the subject of territorial-administrative reform in Ukraine is beyond the scope of this paper, it should be acknowledged that such reform per se is highly controversial due to many political reasons. Several developed and transitional countries preferred to increase the size of the lowest (atomic) units of local self-governance. Germany, Greece, the Netherlands, Denmark, Poland and Latvia are some examples. A principle rationale behind this trend was the need to ensure nationwide equalization of the quality and scope of basic public services provided by sub-national governments to local communities. It appeared that larger local communities were more efficient in utilizing public resources and providing basic public services according to minimum standards. The application of similar reform in Ukraine requires extensive research. However, it should be recognized that deteriorating local public infrastructure, growing regional inequality and changing demographic and migration patterns may call for the revision of the territorial-administrative system of Ukraine in the future.

consolidated budget expenditures actually declined. Although the local budgets continue to finance more than 95% of the consolidated budget spending on public utilities and housing, their share in total social security spending of the consolidated budget (social care and protection, education, healthcare and cultural programs) declined from 74.4% in 1998 to 51.8% in 2006. Taking into account that social security items constituted about 70% of the local budget expenditures in 2006, this downtrend reveals slow progress of decentralization of public expenditures as well.

During the last ten years the flow of funds from the state budget to local budgets visibly accelerated. The ratio of transfers received by local budgets from the state budget to GDP increased from 2.3% in 1998 to 6% in 2007. A rapid growth of transfers from the state budget can be attributed to a shift in the budgeting process brought by the adoption of the Budget Code. This law established formal and more transparent mechanisms of intergovernmental fiscal relations as well as clearly outlined basic social security programs that have to be financed by local governments. If local budget revenues fall short of meeting assigned social responsibilities, equalization subsidies are transferred from the state budget (or budgets of upper level sub-national governments). The amount of the subsidies is adjusted through the equalization coefficient with the size of the local community and fiscal capacity of the local governments. However, budget funds transferred from the central government are primarily used to provide standardized public services that are granted to all citizens of Ukraine. As a result, specific demands of local communities are rather weakly addressed due to the lack of extra budgetary funds. In addition, this centralized redistribution of budget funds erodes the capacity and incentives of the sub-national governments to raise and collect fiscal revenues independently. Furthermore, centralized allocation of public funds encourages local authorities to get involved in the wasteful competition for transfers and grants. Such behavior cultivates corruption and informal personal networks within the state administration, protracting further modernization of fiscal and functional relations between local and central governments.

Although the fabric of intergovernmental financial relations has become more transparent and accountable, the fiscal autonomy of local self-governance has not been radically enhanced. Essentially, a failure to strengthen revenue capacity of the local governments considerably threatens the efforts of the central government to organize and implement a meaningful functional review. In particular, decentralization is listed as one of the preferred options to scale down the central government and improve the performance of operations, currently handled by central executive authorities. This option can only be feasible if local governments are capable of managing transferred functions. A comprehensive functional review of sub-national governments is necessary to judge the readiness of local authorities to accept additional or new responsibilities on public services delivery. Although, in some cases, potential gains from these transfers of government functions may not justify the costs of improving functional capacity of local governments, in many cases, stronger revenue capacity of local authorities may be sufficient to allow for better quality and efficiency of service delivery. Thus, there are several urgent issues that must be addressed to promote strong and capable sub-national governments:

- The size of the public sector and state administration is excessively inflated due to the numerous overlapping of functions and responsibilities of the central and sub-national governments. However, there is little evidence that a functional review of the central government is synchronized with the functional reviews of local governments. Therefore, it is reasonable to assume that the government-backed functional review may fail to detect many flaws in the current assignment of functions between local and central governments.
- The fiscal powers of local governments are still weak. Uneven regional economic development and low revenue collection capacity of atomic local self-governance units restrict the impact of local governments on the welfare of local communities.

- Decentralization of budget resources is in process, yet its speed is still slow, jeopardizing the long-term financial viability of local self-governance. Due to insufficient revenue collection, sub-national governments frequently fail to fund economic and social development projects that are priorities of local communities.
- The central government tends to assign excessive social commitments to local governments since these assignments are often insufficiently covered with necessary financial resources. Most of the transfers from the state budget are absorbed by the nationwide social security programs granted by the central government with little account given to local demands. The primary purpose of equalization subsidies to develop regional economic capacity is underachieved as most of the funds are used to finance social responsibilities delegated by the central government to sub-national governments.
- Local governments in Ukraine support vital public facilities and infrastructure (for example, public transportation, road infrastructure, public housing and utilities) that have an immediate impact on private businesses and citizens' welfare. However, available resources allow for covering current expenditures only, while investments into infrastructure modernization and improvement are negligible. As a result, deteriorating conditions of public facilities (most of which are obsolete, inefficient and rather expensive to maintain) damages the quality of service delivery and imposes a significant burden on local budgets and business communities.
- The impact of local communities on regional public policy making is minimal while the accountability of local governments is weak. The devolution and deconcentration of the central power has not been significantly advanced, which restricts the flexibility of sub-national authorities to implement locally oriented public policies.
- Regional councils form a representative layer of local self-governance. However, only members of the village councils are chosen through simple majority elections. All other councils are formed through party-list proportional elections. In January 2007, the law on imperative mandate<sup>28</sup> was approved by the Parliament, which empowers political parties with the right to dismiss members of the local councils who were elected under the list of these parties. As a result, the impact of the central party apparatus on local policy making has been considerably strengthened, which may further deepen the gap between the policies of local authorities and interests of local communities.

### 5.3. Agenda of Local Self-Governance Reform in Ukraine

Decentralization of government services and resources to sub-national governments is one of the key processes of public administration reform in Ukraine. For this reason, it is necessary to carry out a comprehensive and extensive functional review of the central and local governments with an explicit target to identify functions that must be transferred to the regional, oblast or rayon levels. Improving accountability of sub-national governments is a principle objective of such decentralization, as better accountability and governance allow local businesses and communities to appeal effectively for the higher quality of public policies, regulations and service delivery. The functions of sub-national governments must be aligned on the back of considerations that the private sector, backed by good public policies, should be the engine of economic growth of local communities. Otherwise, uneven development of Ukrainian regions may severely jeopardize the sustainable growth of overall economic activity. In particular, the reform of local self-governance should evolve along the following key directions: (i) the structure and linkages between central and local governments, (ii) the roles and functions of local governments, (iii) local governments' sources of revenue, and (iv) the distribution of public funds between national and local governments.

<sup>28</sup> The Parliament of Ukraine, Law No. 602-V, January 2007

- **The central objective of decentralization reform is to bridge the gap between the local policy-makers and final consumers of public goods and services.** Such a connection should improve information sharing and reduce the political feedback loop, which will enable local communities to exercise more efficient control over the performance of sub-national governments.
- **Decentralization should become a policy vehicle to expand the capacity of local governments to implement policy measures, effectively targeting issues specific to local communities.** Deadweight losses incurred through lengthy bureaucratic approval procedures and cumbersome inter-governmental communication between central and local governments must be minimized. As a result, higher flexibility of sub-national governments to implement local policy initiatives will open many opportunities to improve the social welfare of local communities and reduce costs of doing business through better quality of public services delivery.
- **Successful decentralization assumes a transfer of vital public services to the lower levels of government.** The principle rationale behind this transfer is superior knowledge and competence of sub-national governments to utilize local public resources optimally when addressing the needs of final consumers of public services. A thorough identification of functions that can be performed by sub-national governments is a necessary prerequisite at this stage of the reform. It is critical to evaluate whether local governments have sufficient policy-making and implementation expertise as well as strong revenue capacity to execute and finance transferred and assigned functions.
- **A transfer of economically feasible functions to sub-national governments will improve cost recovery as the inclination of users to pay for public services increases when services are managed closest to final consumers.** This is particularly the case for the most basic services, such as water, sanitation, education and healthcare. Thus, it is fundamental to build a strong payment discipline of users being charged for public facilities and utilities at the local level. For this reason, local authorities must be equipped with fair and market-based mechanisms of tariff-setting for local public services. Unless local communities have complete access to information about the quality and costs of such services, sub-national governments will fail to promote a customer-friendly image and gain the trust of local users.
- **Vertical fiscal imbalances (which arise when local governments lack resources to finance social programs that have been assigned to them by the central government, or which they have adopted for themselves under the local legislation) should be significantly mitigated.**
- The central government plays a critical role in ensuring the stable provision of standardized public services through equalization transfers. However, the operational efficiencies of these transfers should be considerably advanced. It is preferable that the local governments are granted transfers from the central authorities through the project-based funding, which establishes transparent performance and time targets and allows for precise measurement of performance. By establishing a direct link between local governments' efforts and performance, such an approach has the potential to boost economic and operational efficiency of intergovernmental transfers and serves as a strong motivation for local authorities to improve their administrative efficiency
- The ability to expand fiscal revenue capacity of local governments is restricted by the relatively narrow set of local taxes. Thus, the central government should implement policy measures that improve nationwide tax compliance and expand the tax base at the local level. Furthermore, full cost recovery of public services delivered by local governments must be encouraged.

At the same time, decentralization belongs to a set of institutional reforms that may have the highest likelihood of being improperly implemented or failing due to potential conflicts arising during the distribution of responsibility, authority, and financing. It is essential, therefore, to gain strong approval and agreement

between all parties affected by this reform on the depth and comprehensiveness of the decentralization process in Ukraine. The Ukrainian government is urged to refrain from time-consuming and frequently inefficient attempts to balance and compromise the interests of local and central political groups. Decentralization reform should prioritize the development of policy making and enforcement capacities of local authorities. Public services delivery to local communities must be visibly strengthened through (i) broad and critical revision and reassignment of roles and functions of central and local governments and (ii) prompt implementation of reform measures. Any delay with public administration reform at the local level will further deteriorate the quality of public and administrative services, undermine financial sustainability of local governments and widen inequality across Ukrainian regions. Therefore, it is crucial to ensure that the following key processes of decentralization are properly organized and timely executed:

- The functions, authorities and responsibilities transferred to local governments are thoroughly evaluated and precisely defined.
- Delegated functions and responsibilities are clearly assigned to specific local authorities at all levels of sub-national governments.
- The distribution of funds and grants from the central government must be organized through balanced procedures that allow for efficient control over the utilizations of funds at the local level and, at the same time, endow local authorities with sufficient flexibility to invest these resources into programs with the highest priority to local communities.
- The central government should develop mechanisms (including financial and technical assistance, training seminars and channels to share successful experience and knowledge on decentralization reform) that develop strong institutional and financial capacity of local governments to perform their core functions.
- The central government must resolutely commit itself to reducing the costs of doing business at the local level by accelerating nationwide policy initiatives that further liberalize business regulations, simplify taxation and licensing procedures, improve the judicial system, and weed out corruption in the public sector.

## 6. Broad Legal Support for Public Administration Reform

The execution of public administration reform cannot be considered in isolation from the amendments to core legislation that frames public institutions. Laws and regulations establish a basis of legitimacy to public policies, define the boundaries of authority of public institutions, outline policy priorities of the government, and set up relationship patterns between the public and private sector and between various public agencies. Therefore, the capacity of the national governments to draw and execute public policies is rooted in the properly structured and formalized institutional environment. Without strong institutions, neither government nor the private sector can promote economic growth or social progress and effectively participate and compete in the global economy.

Although the evolution of legal institutions and instruments is a country-specific process that is built on unique cultural, political and historical traditions, in all economically successful countries their core tends to converge to the regulatory doctrine that puts the highest priority on citizens' welfare and efficient management of public resources to promote equal opportunities of population in sharing economic and social benefits. Therefore, legal transformations supporting public administration reform must be shaped based on the strategic considerations to achieve social justice and should be free from shaky political solutions securing only short-term gains to political insiders. A strong capacity to form a transparent and stable legislative foundation of public administration is a key aspect of any successful reform of administrative systems. National constitutions as well as other principle laws on public sector administration, including laws on the organization of the central executive powers, local self-governance and budget processes, are a direct source of authority and responsibility of different levels of government. Unless this legislation represents a solid and coherent system, there is always an incentive to abuse legislative gaps with an intention to capture immediate financial and political profits.

The development of a stable and balanced legal system of public administration is undoubtedly a long-term process that in many democratic countries was accompanied by political compromises, fierce competition and unprecedented transformation of social attitudes and values. Developing countries, however, have only a short track of democratic traditions, while their administrative systems are frequently disrupted by prolonged political turbulences and vast institutional inefficiencies, inherited from the past. Even though many of these countries have installed and support democratic legislations, their governments consistently fail to achieve a necessary degree of enforcement and implementation of enacted laws and regulations. This incapacity to maintain the rule of law is a major weakness of developing countries that spells severe problems for authorities to advance with public administration reform.

The degree of constitutional and legislative continuity is an essential determinant of the government's capacity to support good public administration reforms. Frequent and conflicting modifications of the legal environment, accompanied by the relative continuity of the administrative bureaucracy, erode incentives for meaningful enforcement of laws and regulations and deteriorate overall compliance with legal procedures. Under such conditions, public administration is poisoned by the pervasion of informal administrative mechanisms that render formal rules and procedures inferior. Furthermore, strong opposition and inertial behavior of political insiders seriously damages the quality of public governance and considerably restricts the ability to push effective reforms of the government. Weak public governance, in turn, deters the adoption and implementation of the comprehensive legal reform of public administration.

A nation-wide commitment to public administration reform is a key prerequisite to break this vicious cycle and proceed with a quick and effective transformation of the public sector. Undoubtedly, such commitment requires a strong leadership that relies on broad long-term support by political parties and a civil society. Unfortunately, in many developing and transition economies, the initial phase of public administration



reform frequently coincided with volatile and deteriorating macroeconomic performance. This economic background favored short-lived political parties that gave birth to many unstable governments, unable to form strong coalitions and accept leadership to guide the reform of state administration.

International assistance and encouragement are crucial ingredients that can promote the country's leadership potential. It is necessary to acknowledge that the prospect of EU membership was a good incentive for candidate countries to advance legal and public administration reforms. Apart from the need to align national legislations with EU legal codes, efforts to accelerate EU accession were a strong consolidating force that motivated different political groups to partner in implementing economic and social transformations. Although EU accession did not necessarily imply the uniform convergence of the institutional environment in candidate countries, it offered guidelines for establishing properly functioning legal and administrative systems. Countries belonging to other developing regions have been receiving tremendous assistance and advice on how to achieve macroeconomic stability and fight poverty through reforms of the public sector and regulatory environment. The governments of many of these countries have readily realized that enforcing the rule of law and advancing business liberalization is the only way to achieve sustainable private sector-led economic growth. Therefore, it is necessary to continue realigning public policies and procedures to accelerate the adoption and compliance with market oriented legislation.

Institutionalization of good values, principles and processes of public administration is a central component of any legal reform that facilitates restructuring of public administration. The national government should implement legislative initiatives that establish logically structured and coherent organization of the entire state administration. Various government agencies and departments must build a capacity to materialize this framework through their internal organizational structures and interrelations with other state agencies and the private sector. This effort relies on the ability to design and enforce coherent formal codes of behavior as a system of regulations and procedures of day-to-day public policy making and execution. Individual state agencies play a fundamental role in enforcing and disseminating this code of values across the entire organism of public administration. Even if the institutional fabric of the country is properly defined, the failure to internalize good governance principles by the bureaucracy of the administrative units will impede the complete and efficient execution of public administration reform.

Finally, the ability to ensure sufficient support for public administration reform crucially depends on the degree of citizen participation in policy making. In countries with limited influences of the population on public policy, the public trust in the government and its leadership will significantly deteriorate. Therefore, a legal basis of public administration reform must shape public institutions that facilitate representative democracy and expand social inclusion of the population. Such a legal system requires an adequate distribution of authority and responsibilities at different levels of government and must establish a high degree of public sector accountability.

### **6.1. Policy Recommendations for Ukraine**

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Legislative initiatives that go together with public administration reform should represent a comprehensive alignment of the core legislation as well as secondary regulations and procedures that frame the institutional skeleton of the state administration of Ukraine. Building effective policy making and execution capacity of the government is a central goal of this process. Furthermore, administrative reform per se requires legislative rules and provisions that will facilitate its quick and frictionless execution in Ukraine. Therefore, the government should maintain an adequate level of synchronization between the required legislative initiatives and corresponding phases of public administration reform.

- **Ukrainian legislation demands a radical revision to eliminate all existing gaps, confusion and conflicts in the distribution of responsibilities, authority and funds between various state institutions as well as across all levels of government.** A clear definition of the role of the government and a functional review are necessary preconditions to identify these problematic pieces of legislation. The government must build a strong political leadership and accumulate sufficient political will to initiate proper changes of legislation without delays.
- **The results of functional reviews of the government and the revision of its role should be formalized through new legislation or radical amendments to the laws currently in force.** Laws and provisions that allow for duplications of functions across various state agencies and justify execution of non-core operations must be eliminated. It is necessary to ensure that such legislative amendments are systematic and enhance the entire legal framework of the country rather than represent myopic, palliative, trivial and temporary measures. This process has two powerful implications for the quality of public administration in Ukraine. First, more transparent and well-structured regulations will substantially alleviate the burden of bureaucratic and administrative costs on collegial decision making and policy implementation within the government, shortening the gaps between policy drafting, adoption and enforcement. Second, eased red tape and simplified business regulations will enormously benefit the private sector by reducing the costs of doing business. Therefore, all transformations of the legal environment in Ukraine must gravitate to these two key targets.
- One of the central objectives of public administration reform is to introduce innovative and efficiency boosting managerial techniques into the state institutions of Ukraine. If such new policy procedures and instruments are not properly integrated into the current legal system, the benefits from public administration reform will be of limited magnitude. Therefore, **the government should achieve adequate and prompt formalization of all policy tools and instruments<sup>29</sup> that are crucial to perform its core functions effectively.**
- **Competitive markets, served by the private sector, should be the central paradigm of all legislative initiatives.** It is necessary to alleviate legal provisions that justify excessive government involvement in commercial activities, allow for unrestricted market interventions or deteriorate and distort the competitiveness of the private sector. The legislation must facilitate the execution of core functions of the government — not conflict with them or defend inefficient public sector monopolies. Thus, laws or legislative gaps that impede private sector development or restrict its access to markets served by the state (for example, public service delivery or state monopolies) should be abolished, while the reasons for state interference in commercial activities that can be performed by private businesses must be carefully and extensively weighted against the considerations of efficiency and competitiveness. The bottom line is that, through its legislation, the Ukrainian government must establish itself as a partner and supporter of the private sector rather than its competitor.
- **Finally, a functioning judicial system is indispensable for law enforcement and policy implementation. For this reason, the government must without further ado accelerate its efforts on the reform of the Ukrainian courts to build a fair, competent, corruption-free and impartial judiciary system, capable of ensuring effective private property rights protection.**

<sup>29</sup> For example, through the well-structured legal provisions on (i) the instruments of long and short-term developmental policies and programs, (ii) financial budgeting and control mechanisms, (iii) transparent regulations on collegial decision making and cooperation between state institutions and across various levels of government, (iv) measurement of efficiency and performance of state administration and civil service, (v) quality standards and means of public services delivery, including administrative services.

## 7. Private-Public Partnership and Cooperation

### 7.1. Introduction

Many governments have been recently testing a wide range of innovative approaches to public sector management.<sup>30</sup> Tightening budget constraints as well as mounting public demand to improve the quality of public services called for more efficient, economical and citizen-centered models of state administration. Essentially, the public sector (traditionally accounting for a large chunk of the economy, yet much less receptive to market-driven competitive pressures) faced a threat of becoming a serious bottleneck to overall economic development. As private industries have been registering unprecedented productivity gains, slow adjustment of the public sector jeopardized the sustainability of private sector-led growth. Moreover, growing sophistication and globalization of the private economy required the public sector to adopt more flexible and efficient administrative models. These adjustments helped the governments to start delivering a wide set of innovative public and administrative services, which appeared to be critical to sustain and encourage productivity growth and innovations in the private sector. As a result, a rapid evolution of public administration concepts and management techniques have drastically reshaped the roles of the modern state and encouraged the governments to introduce new methods and types of public service delivery to meet the call for the maximum value for public money.

The New Public Management (NPM) doctrine<sup>31</sup> as a synthesis of the best market-style approaches to public sector management is gaining tremendous popularity in OECD member states and is opening a wide range of opportunities for developing countries on their way to more efficient public administration. Although worldwide progress with NPM initiatives is quite mixed, the major promise of the NPM is to strengthen public administration in the increasingly competitive global economy by taking the best inputs from all stakeholders — both in private and public sectors. However, developing and transition economies may encounter one serious endemic challenge. Since not long ago, most of these economies were monopolized by the state, the government may resist accepting its new, less interfering stance on the private sector and the country's economy in general. Therefore, it is crucial to accelerate the introduction of competitive and market-type mechanisms into the public sector.

Active private-public partnership and cooperation represent a broad set of methods of public service delivery, incorporating key market attributes into the commercial or administrative activities controlled by the state. The driving force behind the growing application of this type of arrangement within public administration is its potential impact on the costs and quality of public services delivery. Properly designed market-type mechanisms can guarantee substantial efficiency gains both through lower costs and better quality and can considerably contribute to the economical utilization of public funds.

This section reviews the application of market-type mechanisms and offers a detailed description of typical arrangements successfully implemented by many governments. In addition, it outlines a set of policy measures that have to be pursued by the government to replicate this experience in Ukraine. In particular, the government of Ukraine is urged to expand the involvement of private contractors in the provision of public and administrative services. Indeed, a meaningful functional review demarcates core activities that have to be serviced by the government. Functions classified as non-core and auxiliary operations

<sup>30</sup> The United Kingdom, Australia, Canada and New Zealand are the icon countries that developed distinctive new themes, styles, and patterns of public service management. They were eagerly followed by the rest of OECD countries, as well some developing and transition countries.

<sup>31</sup> The NPM approach has been gaining world-wide popularity since 1980 as a result of the shift from the conventional mechanisms of public sector management to the new managerial paradigm, which opts for the introduction of market-type, complex and innovative techniques in the public sector to boost its efficiency.

must be withdrawn from the government and transferred to the parties that can perform them in the most productive way. In many cases, competitive markets served by many private contractors proved to be the best solution to improve efficiency and scale down the public sector. However, a weak institutional environment and feeble private sector may seriously deter the application of this solution to the functional review of the government. For this reason, the Ukrainian government must visibly accelerate the adoption of necessary procedures and rules that facilitate privatization of non-core public functions. Competitiveness, accountability and reliability of public service delivery are key issues that have to be taken into account when the private sector is selected as a partner to the government. Obviously, private-public partnerships are highly effective arrangements to structure financing, risks and returns of many pressing developmental programs. However, these contracts differ from typical business contracts as they impose distinctly new responsibilities, albeit often indirectly, on the private contractors. Therefore, privatization of non-core functions must be carefully weighed against risks and benefits generated by various types of private-public arrangements in the provision of public services to businesses and the population.

## 7.2. Market-Type Mechanisms Adopted by the Public Sector

a) Outsourcing public sector activities currently performed by in-house civil servants is one of the common market-type mechanisms to privatize non-essential state functions. Traditionally, many governments tended to manage a wide array of in-house commercial activities. Although these activities were important for the reliable execution of core operations, they were virtually protected from market competition, which, in turn, checked efficiency gains in the public sector. As a result, wasteful support of non-core operations put a serious financial strain on state budgets, compelling the governments to reallocate public resources toward the high-quality execution of core operations. At the same time, most of the non-core functions were divested and privatized to achieve cost savings and improve the quality of service delivery.

Essentially, outsourcing implies that the private sector is contracted to supply various services either to state agencies and institutions or directly to citizens on behalf of the government. The variety of services contracted out to the private sector may range from non-core ancillary services (including administrative services) consumed by various government departments to, in some cases, core state functions.<sup>32</sup> A set of outsourced non-core activities usually exceeds a narrow set of maintenance and support services (for example, catering, building cleaning and maintenance) and frequently encompasses services that are important for the overall operational performance of state agencies (for example, information technology, human resources and logistics).

The principle goal of outsourcing is to improve the efficiency of public funds utilization by introducing market competition into the provision of public services. The crux of this approach is in the adoption of administrative practices that closely match conventional business models. The resulting benefits are derived through lower costs of services as well as better quality and reliability of services delivered by the private sector. At the same time, these costs and quality benefits are conditional on a set of critical requirements. If these requirements are well met, outsourcing should become a feasible and efficient alternative to in-house service delivery. A minimum set of conditions conducive to outsourcing usually imply that:

- Outsourcing is a legally viable option — there are no regulatory restrictions on contracting out a specific state function to the private sector.

<sup>32</sup> A privately run prison is the most typical example of a core state function outsourced to the private sector.

- The government consistently achieves unsatisfactory performance (either in terms of quality or costs) in the provision of specific public services.
- The private sector is capable of supplying similar services or products in the required amount and with the established quality standards.
- The outsourced function is not inherently governmental in its nature.
- Market size and sophistication allow for the competitive outsourcing of public services.
- The private sector may provide similar services at lower costs.
- The government has a capacity to enforce adequate monitoring of the quality of services outsourced to the private sector.
- The private sector has better expertise than in-house civil servants.
- In the long-run, the private sector is more flexible to adjust the quality and mix of services supplied to match the needs of final consumers.

Services outsourced by the government can be classified into three broad groups. The first group includes a wide set of standardized blue-collar support and maintenance services such as cleaning and management of buildings, waste utilization, laundry, catering and the provision of guard services. These services are relatively labor-intensive and usually do not represent critical importance to the overall functioning of state institutions. Since this type of non-core operation is common for many business activities, they are provided in the competitive environment and under established quality standards. Furthermore, monitoring and control over the provision of these services is relatively inexpensive, which makes them the first-best candidate for outsourcing. OECD member countries have already contracted out either all or a majority of these services to the private sector. Outsourcing of this type of service in developing and transition countries is more problematic due to the rather large number of low-skilled personnel employed in the public sector, especially in state-owned education, health and social security networks. The state might be willing to secure their employment by maintaining labor-intensive commercial operations within the public sector as outsourcing of these services to the private sector may result in lower employment and wages for low-skilled workers.<sup>33</sup>

The second group of outsourced services consists of commercial activities that are ancillary to the core functions of state institutions. These are mostly professional back-office operations such as information technology, research, legal and audit services, financial and banking services, and human resource management. These operations are generally complex and intensive in skilled labor. For this reason, the provision of such services must comply with high quality standards. In addition, these services are provided in an environment that is more responsive to shifts in policy priorities rather than to market driven developments. Therefore, a private contractor must achieve a sufficient degree of flexibility of service delivery, as institutional discontinuity of the public institutions consuming these services creates intense pressure to ensure timely adaptation to these changes. At the same time, outsourcing of professional public services to private contractors exacerbates the risk of the long-term erosion of human resources in the public sector. This threat may significantly limit the range of application as well as potential benefits of contracting out professional services to private contractors. Since the production of some of these services may heavily rely on the skills possessed by in-house civil servants, the private sector will compete for such civil servants by offering higher compensation. As a result, the government's capacity to resume the provision of such services may drastically deteriorate in the long-run due to the shrinking pool of trained and competent civil servants. This risk is even more acute in developing and transition economies, where the growing private sector aggressively competes with the government for scarce human capital.

<sup>33</sup> United Nations (2005), "Unlocking the Human Potential for Public Sector Performance." World Public Sector Report 2005

Finally, the third group of outsourced services is less common and represents services that are core functions of the state. Although this type of outsourcing is quite rare in developed states, it still dominates certain segments of the public sector in some countries. The outsourcing of prisons (Australia, Canada, United Kingdom and United States), emergency rescue and fire services (Denmark) and food inspection services (Iceland) are some typical examples.<sup>34</sup>

Essentially, the magnitude of economic benefits of outsourcing in-house activities to the private sector is conditional on the ability of the government to establish functioning mechanisms of competitive contracting with private suppliers. Unless such mechanisms are properly designed, outsourcing is unlikely to generate significant savings through lower costs of service delivery and may even worsen the quality of services supplied. Therefore, the existence of competitive markets for outsourced services is a key precondition. At the same time, the capacity to contract private suppliers in a competitive environment depends on the types and complexity of public services. The government may actually contribute to private sector development through the creation of competitive markets for outsourced services due to the large size and quantity of government contracts that require many private suppliers.

However, accountability of private contractors is by far the major concern of contracting out government activities, especially if these activities represent public services supplied directly to citizens. The government is responsible for the stable provision of outsourced services while the specific components of service delivery routines may be executed by both the private contractor and the state agency. As a result, it may be difficult to establish a clear responsibility for the delivery of services to their final users. Furthermore, in cases when public services are provided exclusively by the government, final consumers have more options for remedy procedures that include a wide set of non-judiciary instruments. However, if services are supplied by the private contractors, the range of administrative measures available to consumers to enforce adequate service delivery may visibly shrink.

Accountability of the public sector is certainly a key attribute of good public governance. Although the governments of developed countries have designed effective procedures to ensure transparency and accountability of their operations, outsourcing of public services to the private sector does not guarantee that the same degree of accountability will be preserved. This conclusion comes from the inherent differences of corporate and public governance cultures. The private sector tends to focus on the *accountability of results*, while the public sector devotes closer attention to *process-related values* such as equality and ethics. Outsourcing entails contracts with private parties nurturing divergent economic interests. Private businesses operate in a competitive environment and attempt to maximize their own private profits. Thus, outsourcing presumes that the provision of public services will be performed under corporate ethical codes, which usually represent a narrower set of values than the morals applied by the government. Furthermore, in an environment of weak corporate governance (which is typical for developing economies) the assumption that existing corporate practices can replace or replicate public sector standards may prove to be hard to justify. For this reason, typical outsourcing contracts extend beyond conventional commercial contracts and usually require private suppliers to accept certain elements of the public sector code of conduct. This compliance may be strengthened by requiring private parties to adhere to the formal code of ethics designed for public servants. A specific procedure to incorporate public sector values into private outsourcing contracts depends on the overall development of good governance practices in the country and may range from the formal requirement to accept an approved code of ethics to a more flexible agreement between the parties on the process-related details of service delivery. For example, in Australia, some state agencies require private contractors to follow general ethical rules common for the private and public sector, while other agencies may explicitly enforce stricter regulations that stipulate specific

<sup>34</sup> OECD (2005), "Modernizing Government: The Way Forward."

components of the public service ethical code. Private parties are obliged to comply with these requirements to be awarded outsourcing contracts.<sup>35</sup>

The capacity of private contractors to maintain confidentiality of records on service users is an important facet of public services outsourcing as well. Obviously, in cases when complex public services are outsourced, a private contractor may acquire information to which the access of the general public is typically restricted. However, such information may unfairly improve the competitive advantages of the selected private companies or even jeopardize national security. Although confidentiality of customers is a central value of good corporate practices, outsourcing may open access to a wider set of sensitive information on service users, which may be used for commercial purposes unrelated to service delivery. For this reason, it is important to establish precise boundaries on the types of data that can be obtained by private contractors as well as on the ways this information can be shared and used. Finally, although modern information technology allows for the safe storage and transportation of large databases containing sensitive personal information, governments frequently fail to devote sufficient efforts to minimize the risk of identity theft. Therefore, authorities should develop and actively enforce prudent data-handling procedures that must be adopted by state institutions and private contractors.

Finally, contracting out public services to private suppliers has an important implication for the transparency of service delivery. Unlike public agencies, private companies have a right to not disclose information if it represents commercial confidentiality. As a result, the capacity to monitor service delivery (for example, the control over fairness of established service tariffs) may be limited due to the large amount of undisclosed private information. Obviously, there is a trade-off between the necessity to increase competitiveness of service delivery and to enforce the adequate disclosure of commercial information. In many cases, this disclosure may risk deteriorating the competitiveness of private contractors. As a result, strengthening accountability of the private contractors is a challenging policy objective, the solutions to which vary with the complexity of services outsourced. The flexibility of private contractors to achieve targeted results is one of the sources of lower costs of service provision. The government should not compromise this flexibility by imposing excessive regulations on its private partners and should attempt to strike a good balance between accountability and competitiveness of services outsourced to the private sector.

Finally, the private sector is capable of supplying public services at lower costs due to its higher proclivity to bear commercial risks that frequently cannot be accepted by the public sector. Although the private sector may be better equipped to hedge risks, the impact of these risks on the stable delivery of public services should be adequately assessed, especially in cases when vital public services are outsourced. Therefore, public-private sector contracts should represent a good balance between the necessity to achieve economic benefits from the outsourcing and the attempt to establish an adequate degree of accountability, transparency and reliability of service delivery.

**b)** Public-private partnership (PPP) is a widespread market-type mechanism of public services delivery that improves public sector efficiency through private financing of public infrastructure projects (construction of highways is a typical example) and a transfer of commercial risks to private partners. A typical PPP agreement relies on the long-term sharing of risk and returns and assumes private businesses' involvement in the financing, designing, constructing, owning or operating of public facilities or services. A distinguishing feature of PPP is its potential to redistribute various risks between the participating parties in the way that each party is best equipped to manage assigned risks.

<sup>35</sup> Mulgan, Richard (2005). "Outsourcing and public service values: the Australian experience." *International Review of Administrative Science*, Vol 71(1): pp. 55-70.

There are many categories of commercial risks that are endemic to large scale infrastructure projects. The common negative consequence of these risks is insufficient capacity of infrastructure projects to deliver public services in the required amount and under established quality standards. For example, construction risks may result from the underestimated costs of the projects and delayed completion of some facilities. A poorly designed infrastructure facility places a considerable burden on the government due to the requirement to inject additional public funds into construction. Once construction is completed, the adequate delivery of services may be at risk as well. The government may be required to make regular payments to its private partners even if service delivery is not performed in the agreed amount or its quality does not correspond to the relevant regulations and rules. Finally, the government may bear the major portion of the risk of unstable demand for services, rooted in business cycle fluctuations or driven by exogenous factors. If the government's payments to private partners are not adjusted with the level of demand, considerable demand fluctuations create serious financial pressure on the state budget.

The involvement of the private sector in PPP schemes allows for managing these risks more effectively at all stages of the project, including designing, constructing, maintaining and operating the facility. Essentially, the capacity to transfer risks relies on the long-term financial benefits of the participating parties. If the involvement of the private partner is adequately structured, this partner will contribute to the long-term success of the project at every stage of its execution.

The financing of the project by the private partner is an important attribute of any PPP contract that creates a strong long-term commitment and encourages efficient allocation of risks. In this case, a private partner has a direct stake in ensuring proper maintenance and operation of public facilities, as poor performance will unavoidably result in sizable financial losses. Therefore, the funding of large-scale public projects by the private sector is a good mechanism to improve the efficiency and reliability of public infrastructure. At the same time, the essence of PPP is mainly in the risk distribution between the involved parties. The price of capital for the private sector is usually higher than the same costs for the government, since it always includes a premium for all risks related to the investment. If too much risk is shifted to the private contractors, the efficiency gains may fall short to compensate for the higher private costs of capital to finance public investment projects. Therefore, PPP contracts must avoid transferring risks to the private contractor (for example, a risk of instability of legal provisions, regulating public infrastructure) that are not project-related and cannot be effectively hedged by the private partners. At the same time, the government should not bear most of the project's risks since retaining these risks within the government will erode the ultimate source of efficiency gains from PPP.

Evidently, the performance of PPP projects in terms of *on time* and *on budget* completion is considerably better than the performance of conventional government procurement schemes.<sup>36</sup> In addition, properly designed and executed PPP projects yield benefits that frequently extend far beyond straightforward budget savings on public infrastructure investments. These benefits include design and technical innovations, timely delivery and cost certainty, higher quality and sustainability of public services delivery.

Prior to implementing a specific PPP project, it is meaningful to answer two principle questions: (i) whether the involvement of the government is justified (public interest test) and (ii) how the private sector can best add value to the project under consideration. The answer to the first question is in the realm of the overall functional review of the government. The answer to the second question depends on the capacity of the private sector to allocate sufficient technical expertise and financial resources to guarantee timely and prudent fulfillment of the projects. Obviously, this capacity is conditional on the specific parameters of every private-public partnership. At the same time, a long-term and strategic nature of all

<sup>36</sup> Fitzgerald, Peter (2004). "Review of Partnerships Victoria Provided Infrastructure." Final Report to the Treasurer, Growth Solutions Group, Melbourne.



PPP stipulates a set of common requirements to these partnerships. Several issues have to be considered to determine whether such relationships are feasible:

- The complexity and size of the public infrastructure project.
- Private contractors' technical expertise to execute the project and introduce required innovations.
- The costs of the investment to the private sector and the government.
- The capacity of the government to manage the PPP project.
- The potential of the private sector to increase the value of infrastructure assets.
- The impact of PPP on the quality of services delivered.
- Possibility of a conflict with other stakeholders (local governments, for example) that may limit the scope of involvement of the private sector.
- The capacity of private businesses to manage and operate the facility in the long-term.

A pool of private contractors who narrowly match the government's criteria should be selected to launch negotiations on the implementation of the PPP initiative. To generate maximum efficiency gains from private-public partnership, this PPP contract must include an agreement on the following issues:

- Public vs. private provision of infrastructure facilities must be considered and the private sector should be allowed to manage infrastructure components where it best creates value.
- Due to economies of scale, the government should encourage PPP in projects with a large investment potential to extract maximum efficiency gains.
- Adequate assessment and assignment of project-related risks must be undertaken.
- The government should launch PPP projects where efficiency is strongly driven by design and technical innovations (for example, energy saving projects). Superior private sector access to innovative technologies that can considerably boost productivity and efficiency of costly public infrastructure facilities represents one of the key advantages of PPP projects.
- The government must be equipped with necessary managerial skills and administrative apparatus to handle the PPP project.
- It is crucial to ensure maximum transparency and publicity of all PPP initiatives.
- Any PPP contract should represent a clear and structured system of distribution of risks and returns between all stakeholders.
- The impact of PPP on the provision, maintenance and sustainability of the economy-wide stock of public infrastructure must be accurately and regularly assessed.

**c)** Vouchers represent another common instrument to deliver public services in the market environment. A typical attribute of all voucher schemes assumes a separation of service delivery from the financing of these services. The government issues vouchers to citizens who are eligible to exchange these vouchers for goods or services by selecting one of many private or public suppliers. There are various types of vouchers that allow a voucher-holder either to exchange them for a specific range of services or to pay for a fraction of costs of consumed services. In addition, the suppliers of services may include both private companies and public agencies or may consist of private providers only. The efficiency gain from this

mechanism is yielded through the competitive provision of specific public services, which visibly improves quality of service delivery.

One of the key priorities of vouchers programs is to facilitate access to high quality services by socially unprotected groups of the population — food stamps in the United States is a good example. For this reason, sectors covered by such programs typically supply basic public services, including housing, education and healthcare; in order to participate in the voucher programs, an individual should pass certain eligibility criteria (for example, various criteria based on income, age, health conditions, family size and composition). As a result, this mechanism allows specific groups of the population to consume basic public services by purchasing them in the market at a competitive price, while the government faces a lower financial burden as it is freed from the necessity to maintain the provision of these services directly to designated consumer groups. The ability to organize competitive provision of such public services is a major determinant of quality improvement. However, since voucher programs require substantial financial contributions from the state budget, the introduction of these programs should be strongly justified by higher quality, lower costs and more options of services and goods delivered to voucher-holders.

An appeal for more efficient management of public resources has pushed governments to introduce many innovative approaches in the public sector. The involvement of the private sector in public service delivery is one of the major advancements that aims to improve competitiveness of service delivery with a direct impact on quality and costs of services as well as on social inclusion. In developing countries, the potential for cooperation between the private and public sector in service delivery is rapidly growing. However, the capacity to initiate and manage such cooperation largely depends on the ability to establish good governance within the public sector. Governments determined to maintain effective partnerships with the private sector must undertake thorough functional reviews of their operations, reform civil service and drastically rethink their attitudes toward the private economy. Otherwise, poor public governance may seriously aggravate problems that arise when the public is served by markets. Essentially, weak competition and inferior corporate governance cultures are major obstacles to achieve desired efficiency gains. Moreover, the accountability and transparency of service delivery as well as equitable access to services by the population may considerably suffer. Potential efficiency gains might not be captured since the legal institutions to enforce market competition and fight corruption are especially weak in many developing countries. Local governments may face even tighter constraints on their efforts to engage private partners in the provision of public services due to limited budget resources and an insufficient number of local suppliers. If these institutional deficiencies are not properly addressed, ill-managed private-public cooperation threatens to merely replace public monopolies with private ones. Therefore, private sector involvement in service delivery should logically fit into the overall concept of public administration reform and should be based on the accurate assessment of efficiency gains from the transfer of functions from the public to the private sector.

### **7.3. Policy Recommendations for Ukraine**

Expanding the involvement of the private sector in the provision of public services in Ukraine must be one of the top objectives of public administration reform. The public sector in Ukraine directly or indirectly participates in many commercial activities that can be competitively outsourced to private contractors. The purpose of this process is to improve the quality, efficiency and cost coverage of public service delivery. Once functional review is completed and the fundamental functions of the government are identified and singled out, authorities will have to concentrate on their core activities. Financial and human resources spent on non-core operations should be freed up, while all non-essential in-house activities must be privatized and outsourced to the private sector. An important issue is to build public governance culture that treats the private sector as a partner providing valuable services to the government. Obviously, the government must eventually admit

that private businesses, either through a partnership with the government or independently, are better equipped to supply the public with goods and services that are currently produced by the state. It is critical to overcome bureaucratic resistance (built on a strong tradition of rather interventionist government) and gain broad support within the state administration to divest non-core commercial and administrative operations. The government should principally focus on designing proper regulations, building strong policy making capacity and facilitating competitive markets for the private sector.

- **A thorough functional review of the government should be undertaken to identify functions and operations that can be provided in cooperation with the private sector or entirely privatized and outsourced to private contractors.** This functional review must adopt a critical and comprehensive agenda that prioritizes (i) effective execution of core government functions and (ii) efficient utilization of public resources that are often rather unproductively allocated to operations where state involvement is poorly justified.
- **Privatization, outsourcing and partnership with the private sector should be considered as principal options to boost public sector efficiency, reduce costs and improve the quality of public services delivery. All necessary regulatory procedures and legislative acts should be properly developed and enforced to make these options feasible at all levels of the government.**
- **It is necessary to ensure that privatization, outsourcing and partnership with the private sector are organized through strictly competitive procurement procedures.** The government must adopt a transparent and unbiased approach to the selection of private contractors and place efficiency and quality considerations at the top of its list of requirements.
- **Accountability of public services delivery must be considerably strengthened.** The government should develop and enforce modern quality standards and ethical codes while all parties involved in service delivery must adhere to these rules. Furthermore, user charges for public services must be transparently set on a competitive basis rather than heavily regulated by the state. Competition is a key driver forcing producers to increase efficiency and improve quality of their products and services. Therefore, all government actions that damage market competition must be avoided. Finally, the government must design and implement effective and functioning redress procedures, which can be readily applied by final users to appeal to authorities for better access, quality, transparency and accountability of service delivery.
- There is a large number of workers employed by the public sector<sup>37</sup> of Ukraine, who, excluding civil servants, perform blue-collar commercial services (for example, catering, maintenance and cleaning, laundry). Outsourcing of such services is a straightforward, feasible and efficient option since there are many private businesses in Ukraine that can serve this market competitively.<sup>38</sup> In this case, outsourcing frees budget funds spent on wages and salaries and allows performing support services more efficiently and with higher quality. Outsourcing of more sophisticated services (for example, information technology-related services) opens many opportunities to improve the quality of these services and introduce modern technology into the state administrative machinery, as the private sector has better access to innovative technologies and possesses better knowledge of how to implement such technologies.
- **A good balance should be maintained between the centralized control over the utilization of budget funds and the openness of the public sector to private contractors.** Effective

<sup>37</sup> For example, people employed in public education, healthcare, utilities sectors.

<sup>38</sup> A recent pilot project undertaken by the Ministry of Defense of Ukraine, which introduced competitive tenders for the supply of catering services to the Ukrainian army, indicates that the involvement of the private suppliers can noticeably improve the quality of services as well as save budget resources, previously spent on in-house provision of these services.

cooperation with the private sector relies on the flexibility of all levels of government to select private partners and negotiate contract terms. Therefore, the government should alleviate the excessive bureaucratic burden on state procurement procedures, as well as expand the mandate of local authorities to engage private contractors in public services delivery.

- **The Law on Public Procurements must support competitive and transparent environment for all participants of the public tenders.** Although, a draft of this law, approved in May 2008, is a significant step in that direction, it is vital to achieve good implementation of its provisions. A fight against corruption and inefficient utilization of budget funds during public procurements can be productively performed only if this law is genuinely enforced.

The accountability of public services delivery, including social inclusion and equal access, should be maintained at the highest level. The public must be effectively protected against possible misconduct by the private providers, which may result in a failure to follow accepted responsibilities or ensure adequate quality of service delivery. However, any attempt to impose rather strict requirements on a selected private partner may significantly deteriorate the incentives of the private sector to partner with the government in service delivery. Thus, the government must tailor its policies and institutions to enhance overall corporate governance in the country through the security of property rights, modern and effective anti-trust regulations, energetic promotion of market competition and vigorous and broad protection of consumer rights against fraudulent suppliers both in the private and public sector.

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