

## Chapter 3

# Organizational Structure of Central Government

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*“We tend to meet difficult situations by reorganizing, which gives the illusion of progress while only creating confusion and demoralization.”*

— *Petronius Arbiter, c. 200 BC*

### GROUPING OF FUNCTIONS INTO MINISTRIES

**T**he form of government should follow its function. Chapter 1 dealt with the context of government activity, and its appendix with the nature of the state and of the government, and the types of constitution and political systems. All of these affect the organizational structure of the central government.

The organization of government is not an end in itself, but a means for achieving national objectives. The purpose is to allocate the tasks of government so that they are performed in a manner that is both efficient and economical, with a minimum of duplication and overlapping. It is important to define the areas of authority and responsibility of administrative units, so that they may be properly subject to constitutional and political controls. Sound organization, based on the principle of delegation of authority to ministries, consistent with their competence and responsibility, also encourages flexibility and responsiveness to new policies and developments. Poor organizational structure of ministries is often a major cause of inefficient implementation of government policies (Box 3.1).

A ministry is a primary level grouping of governmental functions, headed by a major political officer known as a minister. In some countries, e.g., the US, such a grouping is called a department. More often, a department is a subdivision of a ministry, and is in turn divided into divisions, branches, and sections, in descending order of hierarchy. In some countries,

the department is known as a bureau, service, or office. Agency normally refers to an entity of government that is attached to ministries and created for special government purposes (Chapter 6).

### Box 3.1

#### Structure of the Ministry of Health and Family Welfare in India

The health ministry is organized under the health minister into three departments: health, family welfare, and medicine and homeopathy. A permanent secretary heads each department. The department of health is laterally supported by an attached professional organization under the director general of health services. Each department operates hierarchically through successive layers of submission of papers for decision making. Below the secretary are two additional secretaries. Each additional secretary coordinates the work of a number of joint secretaries and one of them also heads a project unit for AIDS control. The joint secretaries in turn supervise the work of several deputy secretaries, and through them a number of undersecretaries and section officers.

The secretary allocates the work among the divisions and higher offices, such as the units for the control of different major diseases, the work relating to government hospitals, medical education, international cooperation, health education and communication, procurement, food and drug standards, medical care of government employees, relations with voluntary agencies, and coordination with the provinces. The director general operates a similar hierarchy of health professionals and administrative staff and renders advice to the minister through the main department. The system is highly centralized and prone to delays at every stage. Having to supervise directly a number of large hospitals and to administer a large scheme for government employees leaves the department little time for basic health policy.

Because of the excessive number of layers of authority, there are few mechanisms for internal coordination among the three departments, or for building linkages on health policy with other social ministries. The operation of the department accordingly tends to become budget- driven.

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*Source: Annual Report of the Ministry of Health and Family Welfare, Government of India. 1999.*

## Principles of Work Distribution

There are four principles for distributing the work of government: the *area* covered, the *clients* dealt with, the *process* employed, and the *function* served.

The *areal principle* is reflected in the constitutional or legal arrangement for the division of powers between the central and state/local governments. It is generally not used as a basis for grouping functions into ministries, except in the case of a ministry focused on a specific region for political or development reasons (e.g., the former secretary for Northern Ireland in the United Kingdom [UK]).

The *client principle* applies to certain ministries in some countries charged with the problems of specific client groups, i.e., women, children, or minorities. It is not a general organizational principle. For example, a ministry of social welfare will pay specific attention to the old, the handicapped, poor women, children in vulnerable conditions, and specified minorities. Educational services will be specialized to meet the needs of girls, children not covered by the formal system, those in remote areas, the handicapped, and the mentally ill; industrial development may focus on different types of industries, small and large, export units, foreign investors, and mineral exploitation.

The *process principle* is based on the advantages of concentrating specialized skills and techniques. Examples are ministries set up for public works or water resources or information technology, which are staffed almost exclusively by engineers and professionals. It is more common to find process-based departments are more common in local governments and functional agencies than in central government, since the principle blurs the aims of government action and could create problems of coordination as the scale and complexity of government increases. In central government, it is more common to subordinate process units to a broader functional structure, e.g., locating the information services unit in a ministry of scientific research, as explained below.

The *function (or purpose) principle*, by which government units are organized according to function (e.g., housing, health, defense), has become the dominant principle of organization in most central governments. When grouped according to function or purpose, and the degree to which their outputs and outcomes can be observed (Wilson 1989), government agencies fall under four different types:<sup>1</sup>

- *production organizations*, where both outputs and outcomes can be observed; examples are the internal revenue service, the postal service, and the social security agency;
- *procedural organizations*, where the outputs can be observed but not the outcomes; examples are hospital administration, armed forces during peacetime, and employment agencies;

- *craft organizations*, where outputs are not easily observed, but outcomes can be evaluated. Examples are enforcement and investigative agencies, and various decentralized self-regulating organizations; and
- *coping organizations*, where neither the output nor the outcomes can be observed, e.g., the diplomatic service.

### Principles for Grouping Functions

Within the functional principle, there are four criteria for efficient grouping of tasks: nonfragmentation, nonoverlap, span of control, and homogeneity.

According to the criterion of *nonfragmentation*, all responsibility for a single function should be placed in a single unit. (This is intended to balance the countervailing principle of departmentalization according to clientele.) Nonfragmentation relates both to purpose and to place, the latter coming into play in the case of fragmentation among levels of government and among agencies in the same area. The criterion of nonfragmentation cannot be followed consistently, since unifying responsibility with respect to one function will often lead to fragmentation of responsibility with respect to another.<sup>2</sup> For example, to set up a separate entity to combat drug abuse would cut across other purposes associated with education, law enforcement, public assistance, and health, and lead to the fragmentation of a host of drug abuse programs organized with reference to education, health, and law enforcement. Also, many social problems are so broad that to combine the authority and resources for addressing any one problem (e.g., poverty reduction) in a single agency would logically require rolling the entire government into one administrative unit. Thus, some fragmentation of responsibility among the administrative units is unavoidable.

The criterion of *nonoverlap* implies that no two departments should have the same authority to act in the same circumstances. While jurisdictional fragmentation divides authority, jurisdictional overlap creates redundant authority. Fragmentation makes government ineffective, while overlap makes government wasteful and inefficient.

The criterion of *span of control* involves grouping functions in manageable organizational sizes, and tailoring the workload to the capacities of the minister and his chief officials. Ideally, managerial coordination requires a systematic grouping of functions in roughly equal size blocks, although political and functional considerations are intrinsically opposed to such tidy patterns.

Finally, the criterion of *homogeneity* holds that no single administrative unit should attempt to perform heterogeneous functions or to serve competing purposes. This principle is related to the principle of nonfragmentation.

### **Issues Related to the Allocation of Functions to Ministries**

The allocation of functions to ministries and the choice of number of ministries involve three related issues:

- how important is the function,
- how should functions be grouped, and
- what type of central control is desirable.<sup>3</sup>

The first issue involves determining whether a function is important enough to warrant a separate ministry. Can a new subject, say, biogenetics, be usefully combined with science and technology, or does it really need a separate ministry? Sometimes, setting up a new entity even when not strictly warranted can give an important signal to the population that the issue is taken very seriously.

The second issue is tied to the complex choice of linkages among functions, which influences the performance of all linked functions. For example, should higher education be grouped with primary education or with pure research? Should company law be placed in the ministry of justice or in the ministry of industry?

The third issue, that of central control, has to do with the perceived political value of the function.<sup>4</sup> An important aspect of the politics of allocating functions is the effort of political actors to shape the machinery of government. For example, exporters' interests would suggest separating external trade from other ministries to focus policy and administrative attention on exports; or the chemical companies may push for giving licensing authority to the health ministry than to a more knowledgeable specialized agency.

It is at the highest level of government that the allocation of functions is most political. As one moves down the structure of the ministry, organization is much more determined by practical convenience. New tasks will often simply be added to the existing tasks with which they appear to have the closest affinity. If some new purpose is considered important enough

for a separate unit, it is necessary to show how separate administrative arrangements could be set up without inflicting damage on other functional linkages.

### **Number and Types of Ministries**

The number and designation of ministries vary across countries. For example, there is a single ministry for infrastructure in countries like Algeria, while many other countries have chosen to constitute separate ministries for different types of infrastructure like roads, ports, water supply and sewerage facilities, and railways. Some countries have a comprehensive ministry for industry and directorates for separate industries; others like India have, in addition to a central ministry for industry, separate ministries for steel mines, heavy industry, small-scale industry, petrochemicals, fertilizers, and food processing. Some countries combine industry and trade, while others create superministries to coordinate all the economic work of government. As mentioned earlier, establishing new ministries often signals policy emphases, e.g., ministries for poverty reduction, women, minorities, or the environment.

The importance of the finance and planning ministries and their relative power varies in different countries. Countries also vary in where they locate crosscutting theme areas like women's development, public assistance and welfare, environment, foreign trade, housing, local government, and consumer rights. Specific areas like civil aviation, standards, information technology, and statistics often migrate to ministries over time with no apparent logic. Most often, the underlying reason is the need to accommodate a well-connected politician or bureaucrat.

The functional grouping of ministries must be squared with the requirements of political management. The large size of departments in presidential systems like the United States (US) is partly a reflection of the problems of span of control implicit in a system where a single person is at the top. In a parliamentary government, the prime minister decides the number and workload of ministries, but there are obvious political influences and constraints on this power.

As a general principle, the number of ministries must neither be so large as to impede coordination, nor so small as to place an excessive workload on each ministry. However, the number of ministers may be increased for political reasons in a coalition government (or with a weak

prime minister), generating stress on the task of coordination. Of course, the problem can be solved by allocating subfunctions to junior ministers. This requires the acceptance of hierarchy among ministers, but it could lead to incessant jockeying for position and implies the abandonment of the concept of reasonably compact ministries.<sup>5</sup>

A published record usually sets forth the powers, functions, and organizational structures of all government agencies, with a citation of the relevant laws and decrees and of the basis for the grouping of functions and amendments, e.g., a regulation such as the Allocation of Business Rules in India. The organization chart for each ministry serves as a ready reference on the principal units and the hierarchy relationships and lines of authority. As noted in Chapter 1, it is essential to keep in mind that these formal charts do not reveal the informal relationships, underlying decision-making processes, and actual lines of communication and behavior.

The higher level clusters of substantive functions of government fall into a pattern that can be found, with minor variations, throughout the world. In general, the principal ministries are finance, foreign affairs, internal affairs, defense, information and communications, foreign trade, transportation, labor, energy, law and justice, industry, agriculture, education, health, urban and regional development, social welfare, and public works. There is greater variation in the organizational pattern of the newer functions, such as environment and informatics. (Box 3.2 shows examples from some developed countries.)

Certain functions may acquire new importance because of international focus, technological advance, external aid, or domestic pressure. Such is the case with environment, women's development, control of major diseases, information technology, and communications. There is a temptation for governments, whenever a new function emerges or an old one is enlarged, to entrust it to a new ministry or autonomous agencies (see Box 3.3). The resulting proliferation of ministries and agencies means confusion for the public and complexity for the political executive.<sup>6</sup> Some countries (e.g., the UK and the US) have avoided the temptation to create new ministries, preferring instead to create new units under the existing ministries, or to hive off functions to nonministerial bodies. Elsewhere, there has been a move to reduce and reorganize the ministries and departments in different countries through merger and consolidation. In federal countries, the change in ministries often represents a downward shift of functions to the provinces, and a similar shift is noticed in the case of the devolution of

### Box 3.2 Internal Structure of Government

In Japan, all public administration is conducted today by internal departments or by separate but attached agencies of 11 ministries, each of which is headed by a cabinet minister. All the freestanding agencies have progressively been subsumed under the ministries, leaving only two regulatory agencies outside the system. The basic structure in Japan is the product of the National Administrative Organization Law and the various establishment laws for each of Japan's administrative units.

Australia has 5 parliamentary departments, 18 departments, 46 bodies with secretary powers, 13 bodies with dual staffing powers, 17 bodies with some independence, and 14 statutory authorities. The US Government is organized into departments, independent agencies, and bureaus. The basic operating unit is the bureau. These operating units are so important that the entire executive branch may literally be called a bureaucracy, and one might dismiss the departmental and presidential levels as superstructures.

In countries influenced by the British tradition, the ministries and departments are organized along hierarchical lines extending from the permanent secretary at the top to a number of deputy secretaries and undersecretaries, to divisions or sections headed by desk officers, and, at the lowest level, to an army of administrative assistants and secretarial staff. Superimposed on this system is the corps of staff advisers and technical staff, whose advice is fitted into the hierarchical decision-making process.

*Source: OECD. 1997. Issues and Developments in Public Management. Paris.*

functions in unitary countries to subnational units. In these cases, reducing the size of central government has to be assessed in the total context of public expenditure and service providers. The Government of the People's Republic of China summed it up in the "three fixes"—the fix on functions, the fix on organization, and the fix on personnel—on the basis of which ministries and divisions were restructured and functions were abolished. In general, whenever the organizational structure of central government has not been examined for more than 10 years, a systematic review of functions and organization is advisable.

### Box 3.3 Mushrooming of Government in Bangladesh

Since independence in 1971, the Government of Bangladesh has virtually doubled the number of ministries, departments, and officials. The number of ministries increased from 21 to 35; the number of departments and directorates more than doubled from 109 to 221; and employment in the public sector increased from about 450,000 in 1971 to almost one million in 1992, i.e., at a compound rate of 3.6 percent yearly, compared with the population growth rate of 2.5 percent during the same period.

New ministries, divisions, and departments were created in part to meet emerging needs, such as environmental concerns and women's issues. But the state has also spread its wings more and more into commercial activities. Indeed, the growth of Government has often been stimulated by political considerations. The increase in ministries accommodated more intraparty groups, offered more ministerial positions, and created more jobs to be dispensed by political leaders. Aside from the negative budgetary impact, this expansion has stretched implementation capacity, compounded coordination problems, and exacerbated regulatory intrusiveness. It has also created vested interests that have blocked efforts at rationalization and reform.

*Source: World Bank (1996b).*

### International Patterns

The number of central government ministries averages 16 on a worldwide basis, with little variation among regions from an average of 10 in the small Pacific countries to 20 in the Middle East and North Africa. Within each region, intercountry variation is considerable, however, even taking into account population differences. In Africa, the number of ministries ranges from a low of 10 in Botswana to 28 in Nigeria. The range is from 7 to 35 in Asia, from 11 to 27 in Latin America, and from 6 to 16 in the Pacific. The variation is much smaller in Eastern Europe, the former Soviet Union, and in the Organisation for Economic Co-operation and Development (OECD) countries, with countries clustering around 15 ministries. (See tables below for regional averages and the statistical Appendix III for a list of countries.)

Obviously, countries with large populations tend to have a greater number of central government ministries, as also do countries with a centralized, unitary structure of government. However, the evidence of administrative scale economies is strong: neither the number nor the average size of ministries increases in anything like a proportional way to the size of

**Table 3.1**  
**Number of Central Government Ministries**  
 (various recent years)

Region	Average No. of Central Ministries	Population (thousands)	Population per Ministry (thousands)	Central Government Employment	Average No. of Employees per Ministry
Africa	19	13,942	926	1,046	71
Asia	20	123,951	4,696	1,069	51
Central and Eastern Europe and Former Soviet Union	15	17,813	747	1,264	73
Latin America and Caribbean	15	17,142	1,169	2,275	192
Middle East and North Africa	20	14,992	643	1,390	62
Pacific	10	587	44	5,400	360
OECD Members	14	37,286	3,022	1,658	132
<b>Worldwide Average</b>	<b>16</b>	<b>32,245</b>	<b>1,607</b>	<b>2,015</b>	<b>135</b>

the population. At the extremes, 43 million people are served on average by each ministry in the People's Republic of China, compared with just 1,300 people in the Cook Islands. We will discuss later the significance (or the lack of significance) of these numbers.

Does the number of ministries matter? It certainly matters in the calculation of senior political leaders who are interested in political accommodation, or of rulers who award cabinet posts to personal followers. The issue is also of importance for effective government for a number of reasons. Too many ministries add to overhead costs on account of the staff and infrastructure connected with each new ministry. Each ministry seeks to find new tasks, fueling the bureaucratic pressure for expansion. Problems are created when several ministries perform similar functions and tread on each other's toes. Finally, dialogue and coordination among ministries may be easier to arrange when they are

fewer. However, as noted earlier, the principle of span of control and effective accountability is jeopardized by excessive size of ministries due to a very small number.

At the same time, reducing the number of ministries may produce neither efficiency nor cost reduction. Sometimes, consolidating ministries and reducing their number erodes checks and balances, as was the case in the Republic of Korea before the restoration of democracy. In the absence of external contestability, in more authoritarian governments with little legislative oversight, overlapping ministries are the only source of internal competition to spur efficient performance. It is necessary to look at the real costs as well as the advantages of merging ministries, and consider the possible advantages of overlapping jurisdictions from the citizens' perspective, and in terms of multiple service delivery avenues.

A number of countries in Asia and Africa have reduced the number of ministries and the agencies under them. Singapore was one of the earliest to undertake the exercise. The Government set up a Committee on Reorganization of Ministries, which led to (i) a reduction in the portfolio mix (especially of unrelated functions within ministries); (ii) the transfer of closely related functions in various ministries to one ministry; and (iii) improvement in the central coordination of activities of the ministries and statutory boards. The Republic of Korea has recently passed the Government Organization Act, which reduced the number of cabinet ministers and minister-level officials, to create a government that is smaller but stronger and more efficient, user-oriented, flexible, and responsive to social change, with decentralized authority and responsibilities. Australia reduced in 1987 the number of government departments from 28 to 18, and the Prime Minister further reduced it to 14 in 1996. The People's Republic of China abolished a number of ministries, consolidated existing departments into more homogenous formations, and launched a downsizing exercise under a central unit. And Italy has recently reduced the number of central government ministries to the lowest in Europe (Box 3.4).

Restructuring and privatization in a number of countries has also involved the merger and abolition of some existing ministries. However, as mentioned before, only a detailed study covering all levels of government can reveal whether ministerial reorganization has actually made a difference in total government employment or public expenditure, or just reallocated the same employees and expenditure in a different way.

**Box 3.4****At Long Last: From Fat to Lean Central Government in Italy**

The Italian Government formulated a far-reaching reorganization of the apparatus of central government in 1999, more than 30 years after the 1968 law that first called for the move. This was the first general ministerial reorganization since 1853, before the unification of Italy. Several legislative decisions were taken in that direction in the 1970s and 1980s, but none were implemented. This delay and procrastination also affected the implementation of other important administrative reform measures, including some prescribed in the constitution. It took the peaceful upheaval of the Italian political system, triggered in the early 1990s by a remarkable group of activist prosecutors investigating the scandals of Tangentopoli (Bribe City), to eventually make all those paper plans a political and administrative reality.

The number of central ministries in Italy peaked in the 1980s at 22, and was gradually reduced to 18, still one of the heaviest central government structures in Europe. After the 1999 reorganization, and the parallel process of decentralization, the Italian central government will consist of only 11 ministries and 10 autonomous agencies. (There are also a number of junior ministers for specific portfolios, but without a separate administrative structure of their own.) At the same time, the Prime Minister's Office has been streamlined to strengthen its policy coordination and guidance function, and the powerful provincial prefectures are to be transformed into more modest deconcentrated offices.

The reorganization of 1999 reduced the number of ministries in Italy to less than the 14 central ministries of France and of the UK, the two countries most comparable with Italy in level of development and in economic, geographic, and demographic size. Thus, at the end of the century, the structure of central government in Italy compares favorably in simplicity and organizational logic with that in other European countries. The more difficult challenge ahead is to transform the actual behavior of government entities, and their employees, toward a genuine public service orientation. As all other massive behavioral change, this challenge will require—beyond exhortation and the dissemination of a service ethos—concrete improvements in the framework of incentives (negative as well as positive) and the systematic provision of more “voice” to the users of public services.

In Central and eastern Europe and the former Soviet Union, ministries are reorganized as part of the challenging effort to restructure both the economic and political systems. Three major problems are associated with the persistence of obsolete organizational structures. One is the continued

functioning of institutions whose rationale has changed radically or has disappeared outright; another is the need to create from scratch organs that can address newly defined functions of government in the transition; the third is the grafting of old institutions onto the new system, often in a dysfunctional way (e.g., Poland; see Nunberg, 1995). Changes in ministry structures to adapt to new tasks are a key element in government reforms. Romania, for example, is working on a comprehensive plan to redistribute functions across ministries, reduce the number of directorates, and reduce the number of political appointees.<sup>7</sup>

Typically, reform has involved the merger of the separate ministries for industry and foreign trade, as in the case of Hungary; ministries of interior have shifted from control mode to service mode, in step with decentralization; ministries of education and culture have shed propaganda-heavy aspects of their portfolio; and ministries of finance are in the process of exercising better their key function of allocating public resources. (See Chapter 7 for a discussion of central government expenditure management.) Many ministries are deconcentrating functions and staff to local and regional offices, or hiving them off to local government. There has been no significant trend in transitional economies to set up new ministries. New bodies have been set up mainly to deal with new functions like privatization, often with sunset provisions, as in former East Germany and the Romania.

### **A Possible Central Government Structure for Developing Countries**

Considering the diversity of experience across countries, it is not possible to suggest a single appropriate number of central government ministries. There can be no flat a priori advice. Each country has to choose in accordance with its administrative traditions and political realities. Also, for the experience of other countries to be useful, the comparison has to be between countries of comparable size and political structure. For example, a federal state will, by definition, have a smaller central government than a centralized or unitary structure—but this says nothing about its efficiency or effectiveness. Also, it is important to verify that an organizational streamlining is more than just a cosmetic merger of two separate ministries without any budgetary savings, or staff reduction, or rationalization of functions. (See the earlier example of the Republic of Korea.)

Clearly, however, the extremes are possible to define. Countries like India with 80 ministries and autonomous central departments, or very small countries like the Cook Islands with 14 ministries for 20,000 people, produce

problems of internal coordination, waste, and bureaucratic vested interests. It is neither good economics nor good politics to continue with overextended and mushrooming ministerial structures.

A typical list of central government functions was mentioned earlier. On the basis of the experience and history of different countries, 11 ministries would generally be sufficient in most developing countries to carry out these functions in a manner that respects the organizational criteria discussed earlier: finance and planning (including aid management); foreign affairs (including external trade); information and communications (including postal services, publicity, and information technology); interior (including police and relations with local government); law and justice; human resources (covering education, culture, sports, and science and technology); human settlements and environment (covering urban and rural development, housing and related service infrastructure, water resources, agriculture, and environment); social and labor issues (covering labor, socially and economically disadvantaged groups, women, and social welfare); health and population (including family planning and disease control); infrastructure (including energy, roads, and different forms of transport); and defense (where needed).<sup>8</sup> Italy, after the 1999 reforms, and Japan come closest to this structure.

In any event, the principal challenge is not to define this or that ideal number of central government organizations, but to identify the core tasks of government in the specific country, establish reasonably coherent organizational structures to perform these tasks, and, most importantly, put in place the rules and the monetary and nonmonetary incentives that will induce good performance by public managers and employees (Chapter 17).

## **STRUCTURE AND ORGANIZATION OF REGULATORY BODIES IN DIFFERENT COUNTRIES<sup>9</sup>**

The principles of regulation have been previewed in Chapter 1. This section focuses on the organization of the regulatory function of government.

### **Evolution of Regulatory Bodies**

Countries have set up regulatory bodies for a variety of reasons. The first was the enforcement of health and safety standards, following the uproar over the congested and unhealthy conditions in factories and the exploitative

practices of managers at the turn of the 19<sup>th</sup> century. Governments set up agencies to regulate working conditions and to improve health and safety in industrial units and public places. This regulation was reflected in the earliest labor laws and charters of local governments, and eventually converged with concerns about labor welfare in general, the prevention of child labor, and welfare provisions for women. Special agencies like the Food and Drug Administration of the US were established later to protect the public from adulterated or poor-quality food and drugs.

The regulation of banking activity has been on the agenda of countries since the start of the industrial revolution. This has led to the establishment of central banks in almost all countries to implement monetary policy and to regulate banking activity. The central banking institutions, such as the Bank of England, the Reserve Bank of India, etc., are also in charge of maintaining exchange rate stability and control of foreign investments and remittances in accordance with international practices.

The expansion of economic activity in the last century led to the growth of independent regulatory agencies to ensure transparent competition and consumer protection. The pursuit of competition and the fear of monopolistic exploitation led many countries to set up antitrust agencies. Consumer protection laws and the enforcement of fair business practices called for special enforcement agencies and courts. In some countries, these developments were spurred by consumer movements and the reports of legislative committees on fraud, unfair practices, and insider stock trading. In many countries like the US, statutes or administrative orders governed the establishment of these regulatory commissions or agencies, which had broad discretionary powers over important sectors of the economy. Through various means (licensing, rate fixing, and safety regulations, for example), the agencies regulate major aspects of transportation, communication, power production and distribution, banking, securities issuance and trading, commodities and securities exchanges, business practices, the safety of consumer products, and labor-management relations. Such agencies are also set up at the provincial and local levels in federal countries like the Canada, India and US.

The growing movement for environmental protection and the control of pollution in its various forms, spurred by international concerns, led to the establishment of regulatory commissions for environmental protection and specialized bodies to regulate water and air pollution, hazardous substances, ozone depletion, and other problem areas. Governments have empowered

environmental agencies such as the Environmental Protection Agency of the India or US to prescribe pollution standards in consultation with consumers and business; enforce compliance through a mix of incentives, fees, and sanctions; grant permits for the pollution-free operation of polluting industries; and provide assistance for the installation of pollution control systems.

Market liberalization and privatization have likewise obliged countries to set up new regulatory agencies at the same time as many areas of traditional regulation have come to be viewed as counterproductive. Often, establishing reliable and independent regulatory agencies for utilities, telecommunications, and financial transactions makes a developing country more attractive to foreign institutions and investors. The enabling laws provide for speedy settlement of disputes over the decisions of the regulatory agency through special court procedures.

Amid consumer fears of exploitation by new service providers in the liberalized context, many countries have expanded the role of regulatory agencies to function as industry ombudsmen as well. The agencies provide information to the public on the procedures for awarding licenses, regulating operators, fixing rates, and filing complaints about unfair practices or exploitation. They also consult with user groups through public hearings on rates and licenses, and with advisory councils of the type set up by the British water regulatory authority. The Indian environmental agency is obliged by law to hold public hearings before granting environmental clearance for major projects.

Regulatory agencies may provide service while achieving their regulatory goals. For example, a license to operate a hydroelectric facility, a service to its recipient, may come with several conditions to protect the environment, a regulatory objective. The same holds true of other licenses and permits, including construction codes and regulations. Enforcing of quality standards in goods and services for export also promotes the country's exports, and gains increase confidence in the exports among foreign importers.

### **Organizational Forms**

The regulatory agencies for utilities and the environment tend to be independent bodies, free from executive control. However, many governments also regulate enterprises and citizen activity through government bureaus that are autonomous but not free from control of government. Such is the status of the US Food and Drug Administration and the Occupational Safety and Health, as well as departmental agencies that grant licenses and permits in a number of

countries. In some developing countries, the public sector monopoly in utilities like telecommunications and power supply often also grants licenses to new entrants. To remedy this anomalous situation, certain to undermine the confidence of the private sector in the fairness of the licensing process, independent supervisory agencies were established.

In developing countries, a regulatory body for a utility is usually an independent statutory authority headed by a person with no political leanings but with known expertise in the field (Box 3.5). For example, the regulatory authority for telecommunications would be composed of experts in telecommunications and related fields of finance and engineering. An established convention in a number of countries calls for the executive to consult with opposition leaders and chambers of industry before nominating the members of the regulatory authority. In some developing countries, user representatives are either nominated to the authority or included in an advisory council whose other members are drawn from the industry.

### **Box 3.5**

#### **Electricity Regulation Commissions in India**

The Electricity Regulation Act (1998) of India has led to the establishment of the Central Electricity Regulation Commission and Regulation Commissions for electricity in the provinces. The central commission is empowered to regulate the tariff of generating companies owned by the central government, as well as the tariff of private generating companies operating in more than one state. It also regulates interstate transmission of energy, including the tariff of the transmission utilities. The commission collaborates with the environmental regulation agency in developing policies for environmental quality. It aids and advises the government in matters of policy, resource mobilization, consumer interest, and guidelines for tariff, and is empowered to arbitrate in disputes involving power utilities. Appeals against the commission's decisions can be heard only by the High Court. The state commissions have similar powers within their jurisdiction.

The central commission has five members, and its chairperson is expected to be knowledgeable in the electricity industry, engineering, and finance. The commission is assisted in its activities by a central advisory council representing the interests of consumers, industry, transport, agriculture, labor, nongovernment organizations, and research bodies.

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*Source: Government of India (1998).*

The decisions of the regulatory agency have varied impact, depending on the country. In some countries, these decisions are binding on the government; in others, the decisions are merely recommendatory, although the government, if it disagrees with the authority, must explain publicly its reasons for doing so. The affected parties can sue the government for adverse or discriminatory decisions overriding the authority's decisions. Before deciding on the eligibility of bidders, awarding licenses and permits, fixing tariffs and user charges, or distributing territorial rights for operation, the authority is required to follow due process under administrative law and afford equal opportunity to all the parties concerned. Its quasi-judicial powers under the law allow the authority to conduct hearings and to enforce its decisions on all parties. It is often obliged to hold public or closed hearings with all the stakeholders before deciding a matter, and to disclose publicly the reasons for its decisions. As mentioned earlier, some authorities develop a consumer orientation by assuming an ombudsman role, proactively disseminating information on industry practices and avenues of redress.

Regulatory agencies operate in a manner that varies according to the nature of their functions. Decisions by an environment protection agency, for example, are much more generic than specific to an individual or group. It must hold wider public consultation before enforcing pollution abatement standards, levying charges, issuing environment clearance permits, or certifying pollution control devices. A central aviation authority would monitor airport and airline safety and maintenance, as well as the quality of air traffic control, and license pilots. Increasingly, regulatory agencies in areas like environment and water or air quality, telecommunications, and cross-border transport by air, water, and road are required to work in close coordination with neighboring countries in the region, and often across continents. (See the discussion of globalization in Chapter 1.)

A brief reference may be made to the self-regulation by professionals and industry in a number of countries, which helps to build their public credibility through the voluntary enforcement of codes of good practice, and reduces the need for official regulatory authorities. Examples are the architects councils in many countries; the associations of realtors, brokers, and builders; the fair practices councils set up by business associations to investigate consumer complaints about products and business malpractices; and the groups of industrialists with voluntary codes of ethics for pollution abatement and the disposal of hazardous substances. In a number of countries, industry associations offer to undertake mandatory inspections of workplaces and factories, pollution checks, and other regulatory functions

on behalf of the regulatory agency, subject to sample checks by the agency to verify the reports. Very often, however, such entities really work for the particularistic protection of their members and to exercise political influence, under the guise of self-regulation to protect against wrongdoing.

An important management dimension is the enforcement of their orders and decisions, including redress for breach of obligations. Self-reporting systems require standardized reporting instruments and means for reviewing the completeness and accuracy of data. At the other end of the spectrum are systems that rely on physical inspection, such as the inspection of effluent standards by the environmental agency, or drug and food inspections by the Food and Drug Administration. Rapid and timely inspection and sanctions often require well-equipped laboratories and qualified staff. Where permits are required to carry on an industry or trade, the speed and quality of the regulatory agency's decision and action in issuing the license or permit can be an issue for both environmentalists and applicants. When licenses are limited in number, as with broadcast rights or telecommunication zones, competition is stiff, and adversarial relations with the regulatory agency can develop. The problem may recur when licenses are renewed, or a variation in the original conditions is decided. This reinforces the importance of fairness and transparency in the operations of the regulatory agencies, and the need for governments to ensure their independent functioning, subject to redress from the judiciary.

### **“Heavy” and “Light” Regulatory Options**

Regulatory agencies for economic activity foster competition, promote transparency and predictability in decisions, and protect the operators and the consumers from arbitrary decisions by different actors in the field. A well-designed mechanism that commits the regulator to a clearly defined course of action and reduces the vulnerability of competitors to arbitrary changes in policy can reassure potential investors. International experience shows the wide range of “institution-intensive” and “institution-light” options for regulation, and the variability of regulatory approaches in terms of command-and-control or market-like mechanisms (Box 3.6).

**Box 3.6**  
**Varieties of Regulatory Experience**

Option	Utilities Regulation	Environmental Regulation	Financial Regulation
Institution-intensive	Price-cap regulation, with the regulator setting the price adjustment factor  Regulation by independent commission, with public hearings	Precise rules (command-and-control or, preferably, incentive-based) established by the regulatory agency or legislature	Detailed regulation monitored by competent, impartial supervisory authorities (possibly including some deposit insurance)
Institution-light	Regulation based on simple rules, embodied in transaction-specific legal agreements, and enforceable domestically or through an international mechanism	Bottom-up regulatory approaches: public information, local initiatives to strengthen citizens' voice, and initiatives by local authorities	Incentives structured so that bankers and depositors have a substantial stake in maintaining bank solvency

*Source: World Bank (1997).*

*Institution-intensive approaches* rely on public administrators to manage complex technical problems, and give regulators considerable flexibility in responding to changing circumstances. These approaches also use an array of checks and balances to restrain arbitrary behavior by regulatory agencies and to build credibility. Banking sector regulation all over the world tends to be institution-intensive. Well-designed regulation, monitored and enforced by competent and supervisory authorities, can overcome the information asymmetries inherent in banking in developing countries and detect potentially damaging crises.

The use of price caps in utility regulation in different countries illustrates both the scope of authority of an independent regulator and the role of institutional checks on arbitrary action. A price cap gives the utility

an incentive to be efficient, but can vest substantial discretion in the regulating agency. In countries with weak checks and balances, the private investors may be in a position to manipulate the price adjustment factor to their great advantage, but at the expense of the consumers. The Jamaican case illustrates the danger of having no checks on the actions of the Public Utility Commission (World Bank, 1997). Price controls became so punitive that the largest private telecommunications operator was obliged to sell its assets to the Government in 1975. The experiment, in a number of Caribbean countries, to award long-term nonvariable contracts to single private operators in power and telecommunications has generally exposed the industry and the consumer to high tariffs and poor-quality services.

In general, *institution-light approaches* are easier to implement in countries with weak institutional foundations for regulation, greater chances of arbitrary action by new regulatory agencies under the formal or informal control of government, and inadequate capacity on the part of the judiciary to protect business and citizens from wrong or capricious decisions. Developing countries with weak institutions should assess local capacity and political will to grant independence to regulatory agencies before proceeding with a rash of legislation to set up regulatory authorities, lest public confidence in the competence and fairness of the authorities is undermined.

## IMPLICATIONS OF THE REGULATORY FRAMEWORK FOR PUBLIC SECTOR MANAGEMENT AND ECONOMIC ACTIVITY

### Regulatory Inflation?

As we have seen, basic regulation is a fundamental responsibility of all governments. However, in most cases there is evidence of too many laws and too much regulation. The French Conseil d'Etat (which rules on the legality and propriety of administrative and legal proposals) called the situation "regulatory hemorrhage." The annual production of new laws in France increased by 35 percent over the years 1960—1990, and the production of new decrees by 20—25 percent over the same period.<sup>10</sup> Australia saw a doubling of subordinate legislation between 1982 and 1990. The Indian Commission on Administrative Law estimated the total number of central acts in force in 1998 to be around 2,500, and felt that half of them should be repealed. In the US, the comprehensive Code of Federal Regulations swelled from 54,834 pages in 1970 to over 138,000 pages in 1995.

There is also the mass of ministerial, agency-level, and municipal orders, decisions by independent administrative authorities and tribunals, and government circulars, not to mention the spate of regulations and orders of international regulatory bodies (such as the European Commission or the World Trade Organization) that countries and companies must comply with. Not only is there a plethora of laws and regulations, but they change so quickly that citizens (and sometimes the frontline employees, too) do not know what they contain.

### **Costs of Regulation**

The fiscal and economic costs of regulation, typically not taken into explicit consideration when enacting the regulation, have four main components.

- Fiscal costs to government—the cost of administering the regulatory system itself, including compliance and adjudication. (In the US, on-budget costs increased by about five times between 1970 and 1995, and the staffing of regulatory agencies doubled.)
- Administrative and paperwork costs to businesses and citizens. (In OECD countries, this cost is estimated at 1.7 percent of GDP)
- Costs of compliance—the cost of new equipment, reconfiguration of production processes, relocation, and cost escalation due to delay in the receipt of permits. (In OECD countries, such compliance costs are estimated to be in the range of 10 percent of GDP)
- Indirect costs to the economy, in the form of reduced competition and innovation, and slowed investment.

### **Assessing the Quality of Regulation**

A good quality regulatory system supports national economic performance—defining property rights and avoiding needless litigation, fostering competition, correcting market failures, and promoting fair and equitable market systems. Bad regulation reduces investment, wastes resources, raises costs for consumers, and provides openings for corruption.

Other things being equal, the quality of regulatory enforcement is inversely related in the first place to the quantity of regulation. However, it depends also on the nature of regulations and on the capacity of institutions. Unworkable regulations or draconian rules lead to weak enforcement or widespread evasion, especially in developing countries. Low enforcement

capacity of independent regulatory bodies or enforcement units in existing institutions could result not only in delays and transaction costs, but huge risks for the economy as well. This is illustrated by the costs of the stock market scam in India or the East Asian financial crisis.

## **Deregulation**

Deregulation aims at making regulations simpler and less burdensome for everyone. It involves abolishing out-of-date rules, and making sure that new ones are introduced only when strictly necessary and after exploring alternatives. Many countries have established specialized mechanisms at the ministerial level for streamlining regulatory mechanisms across the government (Box 3.7). These include the Office of Regulation Review in the Australian Industry Commission; the Office of Regulatory Affairs in Canada; the Deregulation Unit in the UK Cabinet Office; and the Office of Information and Regulatory Affairs in the Office of the President of the US. Institutions with an advisory role in setting the regulatory agenda include the French Commission for Public Sector Reform and the Ministries of Economics and the Interior in Germany. Others, such as the ministerial-level Economic Deregulation Board in Mexico and Japan's Administrative Reform Committee (an adviser to the Prime Minister), are deeply involved in reviewing existing regulations and in setting priorities for action by the ministries. As the OECD (1997e) observes, such capacities are most effective if they are independent, horizontal across government, expert, able to take the initiative, and linked to existing centers of oversight and political authority.

Developing countries could start with pilot programs in perceived areas of regulatory costs and immediate priority, and proceed by incremental steps to simplifying regulations to improve service delivery and reduce transaction costs for citizens and business. These would cover strategies like decentralization and delegation, the use of alternate providers, and elimination of unnecessary licenses and forms.

Throughout this process, it must be remembered that the cost-benefit principle is a two-way street. Just as proposals for new rules should be realistically evaluated based on their likely costs and benefits, proposals to eliminate rules should consider the probable impact on the affected groups. Generally, however, the regulatory inflation of the past decades counsels placing the burden of proof on retaining a rule of suspect value rather than on getting rid of it.

### Box 3.7 Deregulation Around the World

There are striking recent examples of deregulation. In 1988, the President of Mexico appointed a “deregulation czar” who reported directly to him. The office operated under a strict timetable to revise or abolish within 45 days a rule regarding which it had received a complaint. The work of this deregulation czar is credited with accelerating regulatory reform and providing access to citizens. The reasons for his success are relevant to developing countries: unequivocal support from the top; provision for overrule only at the highest level; tough penalties for officials who did not comply with the ruling; a definite time limit for action; professional skills of the czar’s staff; and credibility with officials and the public through the opportunity for fair hearing (World Bank 1997)

Brazil set up a Federal Deregulation Commission which managed to revoke 112,000 of the 127,000 decrees written since the beginning of the republic. Turkey completed a codification program which eliminated 1,600 laws and consolidated 12,000 others. India in 1998 set up a Commission for Review of Administrative Law, which recommended the repeal of over half of the central laws and changes in many regulations. In Canada, the Ministry of Finance supervises department-wide reviews of regulations. The US has introduced the sunset clause and staged repeals in most laws, and has authorized Congress to veto any new regulation. The National Performance Review has resulted in the drastic reduction and simplification of many manuals. The UK Deregulation and Contracting Act makes it possible to reduce the burden imposed by the provisions of different acts, through a consultative process of notification. The Malaysian Government has taken initiatives to issue composite licenses for business and investment, extend their period of validity, establish one-stop licensing centers, and abolish certain licenses. The Singapore Registry of Companies and Businesses has allowed the public to correct minor errors by lodging a statutory declaration instead of having to approach the court.

*Source: OECD (1997e); World Bank (1996b).*

## KEY POINTS AND DIRECTIONS OF IMPROVEMENT

### Key Points

The central government in all countries is organized into various ministries (sometimes called departments), and various supporting units within or outside the ministries. Function has become the prevailing principle for establishing ministries and organizing the work of government. In turn, functions are grouped according to the criteria of nonfragmentation, nonoverlap, span of control, and homogeneity. These determine also the rationale for setting up new ministries to discharge a new function. The

country's administrative structure and cultural factors are also relevant to how government is organized. In addition to function, new ministries sometimes can be set up to signal new policy thrusts, e.g., on environmental protection.

The approach is generally to group functions into as homogenous units as possible, in order to facilitate the exercise of distinctive authority by ministers, without overlap or gaps, and thus foster accountability. However, overlapping jurisdictions may have advantages in generating internal debate and providing citizens alternative avenues for services.

The pressure to cut public expenditure and downsize government administration has pushed several countries to reorganize and reduce the number and size of government ministries and departments in various ways. This tendency was reinforced by the moves toward decentralization and the demand of subnational government units for more authority and resources. In transitional economies, the effort to restructure the economic and political systems has naturally required extensive central government reorganization.

As a general rule, the number of ministries must neither be so large as to impede coordination, nor so small as to place an excessive workload on each ministry and cloud accountability. In practice, the number of ministries varies enormously between countries, from close to 100 ministries in some countries to fewer than 10 in others. Each ministry serves an average of 43 million people in People's Republic China, and 1,300 people in the Cook Islands.

Thus the number of central government ministries does matter, not only for coordination, but also to keep down the costs of government and contain the pressures for bureaucratic expansion. Broadly speaking, most countries can manage very well with 12—18 central ministries. However, reducing the number of ministries by itself produces no advantage and in special cases can weaken accountability by producing hybrid entities.

The organization of regulatory bodies is an important influence on the effectiveness of the regulatory function, which is an essential function of government in any country. As noted earlier, regulation has expanded vastly in the 20<sup>th</sup> century. In part, this expansion was related to increasing concern with safety, public health, environment, consumer protection, banking and financial stability, etc. But also, a veritable regulatory

hemorrhage has occurred in most countries, with new regulations added without deleting obsolete ones, or an unnecessary detail in regulations to address a valid public purpose. An excessive amount of regulation not only carries costs for the government and the economy, but worsens the quality of regulation and weakens its enforcement. Accordingly, a worldwide movement toward deregulation began around the late 1980s. In this movement to deregulate, which is appropriate and timely, care must be taken nevertheless not to eliminate inadvertently rules that are necessary and efficient. Therefore, just as new regulations should be subject to a realistic cost-benefit test, so should proposals to remove regulations. Because resistance should be expected from the entities responsible for administering the regulations under review, a serious effort at regulatory streamlining must include the elimination or merger of a number of regulatory entities.

### **Directions of Improvement**

Few recommendations can be advanced in an area as political and dependent on country characteristics as the organization of government. However, certain general approaches can be advanced.

By and large, developing countries are usually more heterogeneous than developed countries and their independence is more recent. Therefore, while the functional principle dominates the organization of central government in developed countries, much of the developing world could usefully consider the value of ministries serving a particular geographic area or clientele, whenever government reorganization appears appropriate.

Also, there is a certain trade-off between coordination and accountability: a larger number of ministries makes coordination more difficult but facilitates the placement of responsibility. Again as a broad generalization, in developing countries weak accountability is more of a problem and a risk than loose coordination of decisions. To that extent, whatever the number of ministries, care should be taken to assure clear assignment of responsibility and rules for accountability. Nevertheless, while the specific number of ministries depends largely on country size, goals, and circumstances, most developing countries of average size can probably get by with 12—18 ministries, and the very small countries with fewer than 10.

Concerning the regulatory framework, the situation is complicated in most developing countries by the regulations inherited from the former colonial authorities, which are not only likely to be obsolete but were

designed in the first place for controlling and exploiting rather than protecting the local citizenry and encouraging competition. To these were added the many more regulations promulgated after independence. Nevertheless, the key issue in most developing countries is not the quality of regulation but its lax and erratic enforcement. Most countries would therefore benefit from a two-pronged effort at regulatory reform by (i) extensively pruning the welter of regulation; and (ii) building the capacity for robust, nondiscriminatory, and predictable enforcement of key regulations—particularly those that protect competition, public safety and health, the environment, and land use.

## NOTES

- <sup>1</sup> Outputs are the goods or services produced; outcomes are the purposes that these outputs are meant to achieve. See Chapter 17.
- <sup>2</sup> Oakerson in Perry, ed. (1989).
- <sup>3</sup> Self (1972).
- <sup>4</sup> Burton (1954).
- <sup>5</sup> Manning (1999a).
- <sup>6</sup> Self (1972).
- <sup>7</sup> OECD (1997b).
- <sup>8</sup> The few countries in the world without armed forces, such as Costa Rica, enjoy typically greater national security than their neighbors.
- <sup>9</sup> This section is drawn from OECD (1997e); World Bank (1997); Fesler and Kettl (1991); Cooper and Newland, eds. (1997).
- <sup>10</sup> OECD (1997e).

