



FINANSDEPARTEMENTET

Ministry of Finance

An Assessment of Funding Systems under seven Ministries and Experiences with Performance- based funding systems

PREFACE

This is an English summary of a report on a study of performance-based sector funding systems. The project has been an important element of the Norwegian Government's programme for modernisation of the public sector. The Ministry of Finance, in conjunction with the Ministry of Labour and Government Administration, has carried out the project.

The first report, entitled «Assessment of funding systems for state entities», a Working Paper from the Ministry of Finance dated 31 October 2003, reviewed principles of performance-based funding. A checklist was prepared to assess the suitability of performance-based funding in relation to the current regime which combines block funding and expenditure ceilings with performance management.

This final report summarises the main conclusions from the assessment of existing systems. It covers:

- * The scope of, and experiences to date with, performance-based funding systems in Norway
- * Some international experiences with performance-based funding
- * An assessment of funding systems in seven ministries, with recommendations for further action
- * Cross-sectoral issues related to the funding of supervisory agencies and voluntary organisations, with recommendations for further action

Anne Kristin Fosli, senior adviser, and Jan Persson, special adviser, both at the Ministry of Finance, have acted as secretariat to the project which has been under way since 2002.

The project will be followed up by the Ministry of Finance *inter alia* through the ordinary budget process.

March 2004

Thorvald Moe
Deputy Secretary General

Contents

	Page
Preface	3
1. Mandate and work method	7
2. Summary and main conclusions	9
3. Elaboration on performance-based funding in	
Norway	21
* The hospital sector	22
* Higher education	24
* The Public Employment Service	26

1. Mandate and work method

This assessment of funding systems for state entities is a cross-sectoral project forming part of the Government's programme for modernising the public sector. The Ministry of Finance has had chief responsibility for the project, and has, in conjunction with the Ministry of Labour and Government Administration and sectoral ministries, reviewed the funding systems for state entities. The aim of the project has been to identify the need for adjustments/changes to existing systems. The first interim report from the project was presented on 31 October 2003 (see Working Paper from the Ministry of Finance of 31 October 2003: Assessment of Funding Systems for State Entities). That paper discusses principles involved in selecting a funding system. It also contains a checklist as a basis for assessing the suitability of performance-based funding for state entities. The present, second, phase of the project has comprised the following two main elements:

A. Assessments of existing performance-based funding systems

This involves, firstly, an appraisal of experiences with existing performance-based funding systems in the field of state service provision in Norway, and of the need for adjustments to the systems. The Norwegian experiences are supplemented with an overview of experiences gained with performance-based funding in some other OECD countries.

B. Identifying areas where changes to the funding systems should be considered

Secondly, areas have been identified where the indications are that existing performance-based funding systems function satisfactorily in terms of results achieved (in terms of quality, user orientation/user choice etc.), cost-effectiveness and cost control, and where alternatives to the current funding systems appear to be available. Areas have also been identified where changes in other parameters may call for reappraisal of the funding systems. Child welfare administration and family welfare offices are pertinent examples. Now that the Central Gov-

ernment has taken over funding responsibility from the county municipalities, the design of the funding systems needs to be reviewed regardless. Another example is the armed forces where organisational changes enable greater use of market instruments in the provision of logistics (including competitive outsourcing by tender) in the same way as in the transport and communications sector.

The aim of the work outlined under B has not been to recommend concrete changes in the funding systems, but to point to areas where conditions may favour alternative funding models. Consideration has to be given to whether changes in the funding models are likely to bring improvements in terms of microeconomic performance, cost-effectiveness and cost control in these areas.

The study has been organised as follows:

- I A review of Norwegian experiences with performance-based funding schemes that have already been introduced in important areas.
- II Visits to Denmark and the Netherlands to discuss experiences with, and viewpoints on, wider use of performance-based funding systems.
- III Selection of seven ministries¹ for initial assessment of the suitability of current funding systems and possible needs for change in various areas. The assessment was based on evidence of room for improvement in terms of performance, user orientation, cost-effectiveness and cost control. Most of these areas are block funded at present. Some areas use simple types of performance-based funding while others have introduced market-based funding systems such as auction/tender. Funding systems were also viewed in conjunction with other major reforms in the areas in question.
- IV Dialogue with the particular ministry to identify areas for closer consideration.

¹These ministries are listed on page 13.

In principle, four main types of funding are employed in the areas assessed:

- * Block funding (combined with performance management).
- * Performance-based funding.
- * Reimbursement schemes.
- * Market-based funding (purchase of services in a competitive market).

The various models can be combined. For example, performance-based funding can be fitted into an overall framework. A scheme can also be partly block funded (basic funding) and partly performance-based, as in the case of higher education and the hospital sector.

Where there are indications that the existing funding system could be improved, the following options are available:

- * Modifying the existing funding system but leaving its main features intact.
- * Replacing the funding system.
- * Combining performance-based funding and block funding.

Activity-based funding, where a unit price is established with a basis in established indicators, is the commonest form of performance-based funding. In the following, the terms activity-based funding and performance-based funding are to some extent used interchangeably.

2 Summary and main conclusions

Elements of performance-based funding have already been introduced in a number of large state-financed service areas in Norway such as primary health services, the hospital sector and higher education. Such funding has also been introduced or is being tested in fields such as private primary schools, job placement, rail passenger transport and within the probation service. Services associated with integration of refugees and immigrants are also funded by simple performance-based systems. Elements of performance-based funding are to be found in the same sectors – and in certain other areas – in other OECD countries.

One may distinguish between two classes of performance-based funding:

- * First, systems for funding institutions/entities, for instance in the higher education and hospital sectors, where the authorities impose performance requirements and grant funding based on results achieved. Funding systems for hospitals and higher education are included in this class. Such systems may in turn be of two types: a) performance-based systems such as entitlement-based schemes combined with preliminary expenditure appropriations, and b) performance-based funding combined with block funding where there is an expenditure ceiling for what the service producers overall can achieve.
- * Second, systems where funding, and hence the activity in the individual institution or entity, is determined exclusively by end-users» preferences and choices. Funding of private primary schools is an example of systems where «the money follows the user».

Norwegian experiences so far are primarily with the first-mentioned class of performance-based funding.

One of the conclusions reached in this review is that wider use of systems in which «the money follows the user» should be contemplated in the social services sector. In other respects, the review of the seven ministries has not revealed sizeable areas where introducing performance-based funding would seem likely lead to significant improvement of performance at present.

Denmark and the Netherlands have somewhat longer experience with performance-based funding systems than Norway. The Netherlands has more experience with pure «money follows the user» systems. Performance-based systems in Norway, Denmark and the Netherlands are variously designed in terms of the balance between performance-based funding and block funding (basic funding), and in terms of incorporating the performance element into a framework. Where hospital funding is concerned, Norway was earlier to introduce such a system than either Denmark or the Netherlands, and is currently employing a larger element of performance-based funding in relation to block funding.

Where education funding is concerned, Denmark was the earliest to act. Since the start of 1990, funding of by and large all cost components in this sector was based on performance. However, after an evaluation in 1998, key aspects of the model were revised to achieve improved cost control.

The argument in favour of performance-based funding systems is that they provide better microeconomic performance and results (greater user satisfaction) thanks to wider user choice and more user-oriented providers. The main argument against introducing such systems is that they may impair cost control and risk «shifting the goalposts».

Performance-based funding was introduced for Norwegian hospitals in 1997. The upside has been higher activity and shorter hospital queues, which was a key aim of the scheme. The new system also improved the range of choices available to patients. The downside has been impaired cost-effectiveness and a significant deterioration in cost control. Based partly on these experiences, the performance-based element of the overall funding was reduced as from January 2004. The impact of performance-based funding on cost effectiveness in the hospital sector is not unequivocal, however. In Sweden, cost effectiveness was seen to increase in the first three years after the introduction of activity-based governance systems, falling thereafter. Even so, cost effectiveness remains substantially higher than prior to the introduction of activity-based governance. More experience needs to be gained with performance-based funding systems in other state sectors before clear-cut general conclusions can be drawn on how the systems have functioned overall.

The Netherlands has given particular emphasis to widening the use of «money follows the user» systems with a view to providing a greater range of user choice, and to encourage greater user-orientation on the supply side. According to a study by the Dutch Ministry of Economy, such schemes have been a valuable tool in achieving improved user orientation and greater user satisfaction. However, according to the study, the introduction of «money follows the user» systems has not improved cost efficiency. Rather, cost efficiency has tended to diminish as a result of higher transaction costs resulting from the replacement of a large

public monopoly by a sizeable number of providers. Cost control has also tended to weaken somewhat. To avoid such impairment, higher user charges or stronger rationing are required, or the funding system must be incorporated into block funding at the ministry level. The Dutch conclusions are consistent with the Danish experience.

As mentioned above, one way of achieving sound cost control is to incorporate performance-based funding into block funding at the ministry level. This makes it possible to prevent performance-based funding within one ministry from impairing overall cost control and thereby displacing activities within other ministries. However, there is still the risk within one and the same ministry that high activity in an area funded on a performance basis will displace activities elsewhere within that ministry.

Another way to promote sound cost control is to design performance-based systems in such a way that total costs, and thereby the overall financial framework, show little covariation with, or are independent of, the level of activity. Parts of the system for funding higher education institutions are designed in this way, specifically research. In this case, higher-than-expected activity will not directly affect total appropriations, only the distribution of total appropriations on the respective institutions. Funding systems designed in this way shift the risk of higher expenditure growth associated with higher overall activity levels from the authorities to the institutions. However, the approach also weakens incentive effects by diminishing the linkage between a given performance and financial rewards.

It follows from the above that predictability both in terms of an entity's activity level and behaviour is an important aspect when assessing the suitability of performance-based funding and, in the event, what role performance-based funding should play in the overall financial framework.

Several OECD countries are presently working to further develop existing funding models, including block financing combined with performance management. This work includes improving instruments of governance and management such as performance indicators, contracts/letters of allocation etc. Denmark is contemplating the introduction of an «accumulation principle»

for state entities that are sole producers. According to the accumulation principle, an entity receives its budget allocations as and when products and deliveries are fulfilled. This corresponds to the principles employed by the Norwegian Public Service Pension Fund which prices its output in accordance with certain principles, partly by way of user charges and partly by way of internal pricing.

As outlined in the first report from this project, a checklist was prepared as an aid when assessing the merits of introducing performance-based funding, see the report of 31 October 2003. Before performance-based funding is introduced, a thorough assessment should be made to ascertain whether better results and greater cost-effectiveness can be achieved in the area in question without this being at the expense of cost control. Estimating the demand for services funded on a performance basis could be difficult in a number of areas. In such cases, performance-based funding may contribute to cost-control problems.

Experiences from the hospital sector in Norway, and in other countries, suggest that the effects of performance-based systems need to be monitored and evaluated with a view to making adjustments and changes.

Assessment of areas under seven ministries suggests that efficiency and effectiveness can be improved by adjusting, or changing, the funding system

Areas under the following ministries have been examined:

- * Ministry of Labour and Government Administration
- * Ministry of Children and Family Affairs
- * Ministry of Finance
- * Ministry of Defence
- * Ministry of Local Government and Regional Affairs
- * Ministry of Social Affairs
- * Ministry of Education and Research

The Ministry of Finance focuses on tax, financial and fiscal matters which largely involve administrative tasks and little in the way of traditional services production. This said, we found it natural, when evaluating funding systems, to start in our own ministry.

In addition to individual areas under the ministries, we also draw attention to two cross-sectoral areas, i.e. areas covering a number of the seven ministries (and other ministries):

- * Funding of supervisory agencies.
- * Funding of voluntary organisations.

The justification for selecting these areas was, first, that no uniform funding practice exists at present and, second, that the areas are relatively large. Gross expenditure on supervision is in excess of NOK 5 billion, while Government appropriations to voluntary organisations add up to more than NOK 4 billion.

We employed the following criteria to select areas for closer assessment:

1. Are reforms in progress in the sector that call for changes in the funding system?
2. Are there any indications that performance, cost effectiveness or cost control are unsatisfactory?
3. Are realistic alternatives to the existing funding system available?

Possible alternatives to be considered are:

- * Modifying the existing funding system but leaving its main features intact.
- * Replacing the funding system.
- * Combining performance-based funding with block funding.²

The assessments were based on alternative funding models that appear realistic in the context of organisational developments in the individual service area. Stepping aside from the Norwegian administrative tradition to see what is possible in purely technical terms, more far-reaching reorganisations of the funding systems are conceivable. For example, where the Ministry of Finance is concerned, administrative tasks could in theory be outsourced or quasi-competitive conditions could be established within or out-

² This mix of systems could transfer the risk associated with overall cost growth from the fiscal budget to the sector being financed. However, potential disadvantages are impaired incentive effects or other activity within the service area in question being squeezed out.

side the ministry. This has been done in some countries. The Canadian Ministry of Finance has outsourced evaluation of forecasts to the private sector. In New Zealand the Finance Minister can circumvent his own bureaucracy to purchase analyses and consultancy services from other state entities or from private firms. Such solutions are not considered in Norway, however.

The portion of public service costs that is financed by user charges varies from country to country. Some countries are tending to reorganise study finance with greater emphasis on course fees. For the student this means that loans and grants are provided to cover both course fees and consumption. In Australia, repayment is related to income, such that what the graduate repays depends on his/her return on the education. A system based on similar principles was recently adopted in the United Kingdom. In the Netherlands, too, course fees are considerably higher than in Norway, and education institutions there are predominantly in private hands. A system corresponding to the one in effect in the United Kingdom and Australia has been assessed in the Netherlands, although there are currently no concrete plans to introduce it. Denmark is not contemplating such a system.

Table 1 shows the results of this review, ministry by ministry. The table specifies the existing funding system, factors underlying the selection of areas and, in a number of cases, possible alternative systems. Budgeted expenditure in these areas totals just over NOK 29 billion (cf table 2). As the table shows, the areas identified are mainly block funded. They are accompanied by two cross-sectoral areas, i.e. supervisory agencies and voluntary organisations.

In particular, areas under the Ministry of Finance, the Ministry of Local Government, the Ministry of Social Affairs and the Ministry of Children and Family Affairs were selected for closer assessment. In the areas of responsibility of the Ministry of Education and Research and the Ministry of Labour and Administration, important reforms have either been carried out or are being planned. In the Ministry of Finance's area no major need to consider changes in funding systems has been identified.

The areas singled out are:

- * **Integration of refugees** is currently financed on a performance basis (subsidy per refugee). Poor results call for adjustments to the system to be considered.
- * Major reorganisations within the Norwegian Armed Forces call for reorganisation of the current block funding system in favour of, above all, market instruments (including competitive outsourcing) in funding the **Armed Forces» logistics activity**.
- * An assessment needs to be made of whether competitive outsourcing of the **operation of asylum reception centres** functions as intended.
- * Funding systems will at all events need to be assessed when responsibility for the operation of **child welfare services and family welfare offices** is transferred from county to state, since county practices are not uniform.
- * In the Ministry of Social Affairs» area, a switch to performance-based funding and introduction of user charges for «**various aids for improving functional ability**» should be assessed as way of improving user choice and user orientation and also cost control.
- * Consideration should be given to whether **basic benefit and attendance benefit** subsidies could be applied in a more targeted manner to stimulate the creation of a good range of services to benefit recipients.
- * An overall assessment of the funding systems for **supervisory agencies** is needed, including the element of user charges, on a cross-sectoral basis, in terms of how they affect performance, cost effectiveness, legitimacy and cost control.
- * An overall assessment of the funding systems for **voluntary organisations** is needed.

Table 1 provides a more detailed overview of the results of the assessment.

Table 1 Areas where reform is under way and areas where reforms should be considered

Ministry/Area	Current funding system	Arguments for considering adjustment to the funding system	Possible alternatives
Labour and Government Administration			
<p>A number of reforms are in progress/under preparation, which include changes to funding systems:</p> <p>Further development of the funding system for county governor offices</p> <p>More effective performance of government administrative services</p> <p>Streamlining of The Directorate of Public Construction and Property.</p> <p>As regards Public Employment Service Performance-based schemes in labour market policy to be expanded</p>	<p>Block funding with distribution criteria</p> <p>Block funding with user charges</p> <p>Block funding with user charges</p> <p>Block funding combined with performance-based funding</p>	<p>Improved performance</p>	<p>The reforms entail increased use of market instruments and elements of performance-based funding within an overall financial framework</p>
Children and Family Affairs			

Ministry/Area	Current funding system	Arguments for considering adjustment to the funding system	Possible alternatives
Family welfare offices	Block funding	Organisational change with responsibility for operation transferred from county to state. Wide variation in costs	
Subsidy to juvenile refugees	Preliminary appropriation, activity-based funding	Subsidy scheme partly overlaps integration subsidy	Assess possibilities for further development of current activity-based system. This subsidy and the integration subsidy must be viewed in conjunction
Child welfare administration	Block funding	Organisational change with responsibility switched from county to state. Wide variation in costs	Elements of tender procedure/competition
Finance			
Work under way to increase market's role in central government funding (accounting and financial services), as required by revised financial regulations for central government dated 1 January 2004.	Block funding		
Defence			
Logistics activity	Block funding	Activity reorganised	Competitive outsourcing on a larger scale
Local Government and Regional Affairs			
Operation of state asylum reception centres	Block funding / tender procedure	Competitive-outsourcing system needs evaluation	Consider changes in the competitive-outsourcing procedure

Ministry/Area	Current funding system	Arguments for considering adjustment to the funding system	Possible alternatives
Refugee integration subsidy	Block funding / activity-based funding	Unsatisfactory performance. Incentive problem	Consider possibilities for further developing the current activity-based funding system to alleviate incentive problems
Norwegian-language tuition for adult refugees	Block funding / activity-based funding	System needs evaluation	Consider possibilities for further developing the current activity-based funding system
Subsidies for establishment, renovation and rental dwellings	Block funding	More user-oriented housing subsidies	Provide a larger share of housing subsidies in the form of living allowances
Social Affairs			
Subsidies to local authorities for resource-demanding users	Reimbursement. Shared responsibility for funding	Reimbursement scheme gives little incentive to cost-effectiveness. Weak cost control	Prepare objective cost criteria enabling the scheme to be incorporated in the block subsidy to local authorities
Basic allowance	Preliminary appropriation	Ensure a good services offering for the disabled. Assess distributional effects	Consider whether parts of the support might be given in the form of vouchers for the purchase of specified services combined with user charges

Ministry/Area	Current funding system	Arguments for considering adjustment to the funding system	Possible alternatives
Attendance allowance	Preliminary appropriation	See comments under basic allowance Coordination in relation to other benefit schemes	Consider whether parts of the support might be given in the form of vouchers for the purchase of specified services combined with user charges View allowance in conjunction with pay to persons with especially burdensome caring work
Various technical aids to improve functional ability	Block funding	Opportunity to enhance user orientation and cost-effectiveness	Greater element of competition, greater commercial responsibility for services. Lay basis for user charges
Education and Research			
<p>Reforms in progress and under preparation in several areas with greater or lesser effect on funding mechanisms</p> <p>– upper secondary schooling</p> <p>– research (within higher-education funding system)</p>	<p>Included in block subsidy to county municipalities</p> <p>Block funding combined with performance-based funding</p>		<p>The reforms entail laying a basis for performance-based funding at entity level</p> <p>Measurement problems and incentive problems connected with activity-based funding need to be monitored and evaluated</p>

Ministry/Area	Current funding system	Arguments for considering adjustment to the funding system	Possible alternatives
- the funding system for universities and colleges is to be evaluated and in the event modified accordingly	Block funding combined with performance-based funding (two-year lag)		

Cross-sectoral assessments

<i>Supervisory agencies</i>	Block funding. Fees levied	Transparent funding systems that contribute to sound resource use by supervised entities / supervisory agency	Consider funding model, degree of user funding, system of user funding
<i>Voluntary organisations</i>	Block funding, user funding and performance-based elements	Clarify the principles of current funding systems	Consider whether performance-based / market-based funding models might contribute to improved performance / greater efficiency

3. Elaboration on performance-based funding in Norway

Many factors have a bearing on the impact of introducing performance-based funding systems, including characteristics of demand for the services in question, the extent of user charges and other rationing mechanisms. Factors on the supply side are also of major significance. Where competition exists between entities, funding of such entities may vary with the results achieved, without this being at the users' expense. Designing a system that does not penalise the users is more difficult in the case of a monopoly, and is also a challenge where performance management is concerned.

If performance-based funding is to have the desired effects, the financial incentives must be appropriately designed. Competition between providers (public or private) in an activity-based funding system is not in itself a sufficient condition for cost-effective production. The financial incentives must also be properly configured with reference to the results desired. If the unit price is too low, there may be too little to be gained in producing services at the desired quality on the desired scale. On the other hand, if the unit price is too high, it may be tempting to over-dimension service production capacity, thereby impairing the incentive for cost effectiveness.

The hospital sector

Funding schemes in the field of specialist health services have been subject to broad-based assessment, cf. NOU 2003: 1 entitled «Need-based funding of public health services».

The aim of introducing activity-based funding in the hospital sector was in the first instance to boost activity without impairing cost effectiveness, thereby reducing excess demand and hospital queues. Activity has been very high, higher than expected, necessitating substantial additional expenditure appropriations.

The fact that activity-based funding only covers part of the overall costs expenditure, and is set lower than the marginal costs, should in principle help to discipline hospitals (provided that the block-funded part of the subsidy is fixed). Where overall costs are lower than the cost estimates on which the block subsidy was based, the hospital's revenues will exceed the costs incurred by the hospital under the DRG³ system. Where total treatment exceeds the projected treatment, on the other hand, revenues will be lower than overall costs under the DRG system. This mechanism should in principle move actual activity towards the stipulated level. Given the excess demand for these services, the strength of this mechanism will diminish with an increasing share of activity-based funding. However, the mechanism is too coarsely calibrated to enable it to be used for precise budget man-

³ DRG stands for Diagnosis Related Groups.

agement. Erroneous perceptions on the part of producers may also create a problem in this context. At some hospitals perceptions appear to have arisen to the effect that activity-based funding exceeds the marginal costs. To the extent that such perceptions become entrenched, and are erroneous, the system will not curb production but may instead lead to deficit accumulation, which in the next instance could serve as an argument in favour of increasing block appropriations in the short term.

Queues may, also under this financing system, arise in situations where hospitals do not find it profitable to increase production, in the same way as in the case of full block funding. Should the actual funding requirement proved to be larger than projected, either administrative measures will have to be applied in order to ration demand, or additional appropriations (both in the form of increased block funding and unit-price reimbursement) will have to be granted to cover the deficit. It has in practice proven difficult to avoid sizeable additional expenditure appropriations, also under the new system.

Growing pressure on budgets after the switch to activity-based funding may be due to the fact that excess demand is perceived somewhat differently by users under this system than in the case of full block funding. In the latter case the users will face clear capacity constraints on the supply side. It may be easier to win acceptance for the need to impose rationing in such a system than in a situation where it is obvious that increased funding through an increase in the unit price or in the basic appropriation will stimulate activity and thereby improve the coverage of overall demand.

The main conclusion of the White Paper that reviewed the funding system was that the current regime of activity-based funding and basic expenditure appropriations should be continued and further developed.

- * The basic appropriation was to be increased by a margin corresponding to a reduction from 60 to 40 per cent in the activity-based rate and a similar reduction in the rate for out-patients.

- * As from 2004, the subsidy for outpatients was to be paid to the regional health enterprises in the same way as activity-based funding.

The rationale for this adjustment to the prior activity-based funding system is that recent years» substantial growth in patient treatment has reduced waiting lists. At the same time, and by the same token, the need for a strong impetus to further growth in facilities for patients is just as pressing. In some areas the presence of some degree of overcapacity cannot be ruled out. Greater attention is needed to ensure that resources are focused on prioritised areas. A better balance between activity funding and basic appropriations will support such an objective. That is why the Storting, in keeping with the Government's recommendation, raised the basic appropriation and lowered unit prices in the overall state funding of the regional health enterprises.

Higher education

Budget appropriations in the field of higher education comprise three components: basic funding, a tuition component and a research component. For the sector as a whole these components constitute respectively about 60, 25 and 15 per cent of the appropriation to public education institutions. Private colleges receive considerably lower basic funding, and the amount varies from one institution to the next. The tuition components and parts of the research appropriation are allocated by way of performance-based funding systems. The basic appropriation represents basic funding for research and educational activities. A fixed financial framework is employed for the budget year. The performance achieved within the tuition segment two years previously forms the basis for the tuition component in the budget proposal for the coming year. Should the entire sector increase its production, this will in isolation entail an increase in the budget appropriation to the sector.

The aim of the new funding scheme is to encourage institutions to focus more sharply on the objectives of the quality reform as formulated by the Ministry of Education and Research. The ob-

jectives include raising the quality of higher education, ensuring a higher student throughput, and so forth.

The funding system is designed with a view to supporting the main objectives of the quality reform, and may be seen as part of this reform.

Since the above funding system has only been in operation for two years, it has not yet been subject to evaluation. The Ministry of Education and Research has however started work on evaluating the quality reform, the results of which will not be available for some years. Evaluation of the new funding system will be part of this process.

The perception among the above ministry's administration is that the funding system has played a guiding role for the institutions and provided an incentive to shift the focus towards the students, the course facilities and the quality of the education provided by the institutions. There is also an awareness that the introduction of performance-based funding could affect the registration of the activity, and that incomplete performance criteria may result in shifting goalposts.

According to the data for 2002, activity has increased overall compared with 2001. The student population has grown, and student attainment overall is higher. This may be a result of the funding system, but may also be due to other reforms within the sector. The system needs to work for a longer period before reliable conclusions can be drawn about its effects.

The way the funding system works means that changing activity levels in higher education will be reflected in overall expenditure appropriations to the sector with a time lag of two years. It is not clear how the system will affect cost control in the longer term. Low activity in 2001 led to reduced budget allocations in 2003. The result for the sector as a whole was a net reduction of NOK 12.8 million. In 2004 appropriations will increase due to relatively high activity in 2002, and the sector will receive an increase of NOK 200 million as a result. Performance-based research funding only affects the relative distribution of budget funds between institutions. The overall budget may also be changed via changes in the basic expenditure appropriation.

The Public Employment Service

In the field of **labour market policy**, activity- and performance-based funding schemes have been introduced in limited areas on a trial basis. A distinction is drawn between internal schemes whereby the public employment service is funded and rewarded on the basis of performance, and external schemes whereby players are funded and rewarded on the basis of specific criteria. The schemes are geared to a system of block funding, and there is a cap on the overall appropriation to the purposes in question. Appropriations to activities over and above budgeted activity are triggered through a reserve retained by the ministry or through reassignment of priorities within the ministry's financial framework.

Internal funding schemes on a trial basis at the Public Employment Service:

1. *Activity-based funding for assessment of occupationally handicapped persons whereby the public employment service receives a payment for each completed assessment of an individual's employment opportunities etc.*
2. *A bonus for timely and correct payment of unemployment benefit.*
3. *A bonus for more efficient use of employment measures and implementation of such measures (recently introduced).*

External funding schemes on a trial basis at the Public Employment Service:

4. *bonus to other agents for job placement of vulnerable groups on the labour market (long-term unemployed and occupationally handicapped persons).*
5. *bonus to the public employment service and other agents for job placement of persons in receipt of pay pending new employment.*
6. *A bonus to organisers of job clubs and job seeker activities. Start-up: Spring/summer 2003.*

Moreover, the ministry is planning a trial scheme involving the use of government-funded private job placement facilities as a labour market measure.

All trial schemes were started in 2002 and 2003, and will continue in 2004. An evaluation has been initiated under the auspices of Telemarksforskning (a research and development institution) to investigate the overall effects of all external and internal trial schemes on users, the public employment service and external providers.

Preliminary assessments are that the projects have had a favourable impact. the internal projects are concerned, good results can be pointed to, for example in the shape of shorter queues for the occupationally handicapped as well as gains in terms of meeting targets for timely and correct payment of unemployment benefit. Where the external projects are concerned, great interest is being shown by external providers. It is too early to say why these effects have arisen or whether the schemes have incentive effects that shift the goalposts in relation to other measures, and if the financial incentives have been correctly deployed making it possible to take out productivity growth and increased cost effectiveness combined with good cost control.

Cost control achieved where any overruns in the performance-funded areas are covered by way of budget reallocations. The new funding schemes in the field of labour market policy may however in isolation lead to greater use of occupational rehabilitation resources which are appropriated on a preliminary basis. It is important to view this in conjunction with a possible reduction in costs resulting from speedier assessment and shorter periods spent on labour market measures.