

The New Zealand Reforms – They Worked in Theory: What about the Practice?

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November 2000

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1. INTRODUCTION

The purpose of this presentation is to provide an overview of the New Zealand experience of public sector reform, not as a prescription for what the Hong Kong Government should or should not do but to draw out some lessons from that experience to better inform your thinking about the utility of the New Zealand model, as it is sometimes called.

Allen Schick, an internationally respected commentator on public management, in a paper providing a comparative overview of public sector reform, described the New Zealand approach in the following terms:

“New Zealand, which has advanced much further than any other country in establishing internal markets relies on a network of contracts to formalise relations between in-house purchasers and providers. It has performance agreements for department heads, fixed-term contracts for senior and middle managers, purchase agreements for ministers to contract for services at agreed prices from departments, and contracts by which departments purchase services from other government entities.”(Schick, 1999)

By any measure, New Zealand’s programme of public sector reform has been radical. Why should such a small and isolated country have embarked on a programme which has attracted so much international attention both for its comprehensive nature and the theoretical framework which underpinned it?

To understand this, and to provide a context for the lessons from the New Zealand experience, it is useful to look briefly at the background to the reforms. Before doing so, though, I provide a road map for the paper.

2. ROAD MAP

This paper will cover the following material:

Background. An overview of New Zealand's economic situation and public sector at the time of the 1984 election (which brought the reforming Labour Government to power) and an outline of the political structure which underpinned the ability of New Zealand governments to impose major change.

Diagnosis. An outline of the problems which were seen as confronting the public sector, and an overview of the theoretical framework developed to address them.

What did we do? The shift to accrual accounting and a cost of capital for government departments. The basis of structural reform including defining the separate interests of the Crown. Corporatisation and the use of the company model. Restructuring the core state sector including the emergence of the autonomous chief executive, the basis of the contractual state and the separation of the Crown's purchase and ownership interests.

Lessons from the New Zealand experience. These are considered under six separate heads; focus, the collective interest of Government, capability, succession planning, public sector ethos and the output/outcome relationship. This latter item is explored in some detail on the judgment that this is the single largest piece of "unfinished business" and one from which other jurisdictions may have most to learn.

Conclusion. Comment on the relevance of New Zealand's experience as a valuable source of learning for other public sector reformers.

3. BACKGROUND

1984 was something of a watershed year in New Zealand politics. A snap election was held in the middle of the year in conditions of economic crisis. The incoming Government was forced to deal with a major foreign exchange crisis even before it was sworn in. The economy was highly regulated, with a comprehensive wage and price freeze, import licensing, very strict controls over the financial sector, an extensive and often conflicting programme of subsidies (as an extreme example, agricultural subsidies exceeded the net income of the farming sector which included the country's main export industries) and a highly regulated labour market.

Within this, the public sector itself had a number of weaknesses or what were seen as sources of inefficiency including:

- substantial conflicts of interest with departments responsible both for policy advice and service delivery
- quite rigid controls over inputs, including staff, so that managers had little discretion over key areas of their operations
- little information on the linkages between departmental outputs and their effectiveness in achieving objectives
- inappropriate structures - the state had very extensive interests in business, with a number of major businesses operating in a conventional departmental form and with few of the financial or other controls characteristic of their private sector counterparts.

Many of these difficulties, both in the public sector and in the wider economy, were seen as being at least partly a consequence of the structure of central Government itself. New Zealand is one of a group of countries sometimes described as Westminster democracies; countries which broadly speaking adopted the British parliamentary system. However, there were important differences which help explain both the situation in which we found ourselves in 1984 and why we were able to implement such a comprehensive programme of reform without any significant (effective) opposition.

As with the United Kingdom, New Zealand's executive Government is formed by the party or parties which have a majority in the Parliament. However, New Zealand lacks many of the checks and balances inherent in the British system. First, New Zealand has no upper house thus removing an important source of scrutiny for government legislation.

Secondly, the small size of New Zealand's Parliament (with about one sixth of the number of members of Parliament in the Westminster Parliament) allowed for very tight control. Under the National party which formed the Government between 1975 and 1984, the party leader was automatically Prime Minister and had the right to appoint and dismiss members of the

Cabinet, something which gave a strong Prime Minister effective control over important cabinet decisions.

Typically the Cabinet itself included half or more of the members of the ruling party. The Westminster principle of collective Cabinet responsibility meant that Cabinet effectively controlled discussions in and decisions by the party's parliamentary caucus as members of Cabinet were bound by this convention to speak and vote in caucus in support of cabinet decisions. Finally, because the party had a majority, caucus decisions determined how Parliament decided any issue on which it voted.

Over that period the New Zealand Prime Minister, the Hon Robert Muldoon, also held the portfolio of Minister of Finance thus giving him very tight control over information flows from the Government's principal internal critic, the Treasury.

This concentration of power in the hands of one person has seen the New Zealand of the time described as an elected dictatorship -- what the Prime Minister willed the Prime Minister got.

It also, however, provided the means for developing and implementing a very comprehensive reform programme. The Labour Government which took office in 1984 had essentially the same controls available to it as the previous government (the one difference of any significance between the two parties is that a Labour Prime Minister does not have the right to select the members of his or her Cabinet -- they are elected by the party's parliamentary caucus -- however he or she has both the right to allocate portfolios and to dismiss ministers from the Cabinet). It was thus able to push through a major reform programme very rapidly on the initiative of the Prime Minister and a few key colleagues.

4. DIAGNOSIS

In the late 1970s and the early 1980s there was a growing sense of awareness, within the New Zealand public sector, that all was not well. In 1978 the Report of the Controller and Auditor General on *Financial Management and Control in Government Departments* concluded that accountability to Parliament was inadequate, with insufficient information in the Estimates and departmental reports on programme objectives, achievements and full costs. (Controller and Auditor-General, 1978)

The Treasury had become increasingly critical of government policy and of the inefficiencies and distortions resulting from the very widespread and complex net of government interventions in the economy. Its advice was substantially ignored – for example it strongly resisted the introduction of a wage and price freeze pointing out, quite correctly, the damage which it would actually do – but this advice was specifically negated. Effectively, during the period of the early 1980s, Treasury was shut out of the policy process on any matters where its views differed from those of the Prime Minister/Minister of Finance.

Treasury's senior management used this time to research and develop possible solutions to the quite deep-seated problems it saw as facing New Zealand, including the structure and management of the public sector.

The pre-1984 Public Management Scene

Amongst the key features of pre-1984 public management which were seen as in need of reform were:

- a unified public sector. The State Services Commission employed all public servants and so was able (indeed required) to impose an integrated career structure including service wide terms and conditions of employment, training and development. This was seen as working against the need for flexible resource management if departments were to be responsive to changing conditions
- cash accounting with its usual problem that nobody knew the true cost of public sector activity and quite major costs, such as depreciation or the present value of contingent liabilities, could be completely ignored
- consistent with this, public sector activities, including trading activities, were funded on an input basis. This meant that it was extremely difficult to get any real idea of the cost of individual activities or their effectiveness. Change took place only at the margin with new activities typically funded either by new money or by a requirement for departments to give up old money, something which allowed for considerable game playing as departments offered up programmes which they knew ministers wanted to keep
- the typical government department included a number of potentially conflicting activities -- the classic being the department which was both the Government's policy advisor and its service provider with a clear risk that policy advice might serve the departmental interest in continuing service provision rather than the government interest in getting the best and cheapest outputs
- extensive involvement by the state in trading activities -- New Zealand had a huge collection including banks, insurance companies, forestry, farming, the country's major airline and railroad, its largest trustee company and much more. Running these on departmental rather than commercial lines caused more than a few problems.

The Treasury had summarised what it saw as wrong with the public sector in its 1984 post-election briefing¹ "Economic Management" in the following words:

"In summary, the major criticisms that can be levelled at the public service are:

- a) Most departments have no clearly defined goals;
- b) Most departments have no clearly specified management plan;
- c) There are few effective control mechanisms to review the performance of departments in meeting their output requirements;
- d) Departmental managers have little freedom to change the way their departments operate to meet their goals, especially in staffing matters. They lack the autonomy they need, within an overall expenditure limit, to use their judgement to produce the best outcome;
- e) Too much emphasis is placed on the control of inputs;
- f) There are no effective review mechanisms for dealing with poor performance in senior management within departments.' (The Treasury, 1984)

By necessary implication, this was a rejection of the concept of the unified public sector with its integrated career structure, strong preference for internal appointees over outsiders, and a promise of lifelong employment.

¹ It had been the practice for government departments, before each election, to prepare a briefing for the incoming government prepared without making any assumption as to which party would form government. The purpose was to provide the new government, whoever it might be, with as objective an overview as officials could provide of the key issues which the incoming government would need to address. Beginning with 1984, the practice was adopted of publishing those briefings so that they were publicly available. The decision to do so was taken by the newly elected Labour government. The immediate motivation for doing so was to provide the public with information on just how badly the previous government had performed.

New Institutional Economics: A Framework For Rethinking The Public Sector

New Zealand was not the only country going through a rethink of the structure and role of its public sector. Most of the Westminster democracies were reviewing their arrangements, typically driven by the need to control ever-increasing public expenditure and spiralling public sector debt. The crucial difference between the New Zealand experience and that of other countries such as the United Kingdom or Canada, lies in the approach taken and the theoretical framework used to inform that approach.

In the United Kingdom, public sector reform was driven primarily by insights drawn from management theory and practice – a sense that there was much that the public sector could learn from the business community in gaining a better focus on its activities. The process the then government followed in its single most significant reform, the creation of the Next Steps (now Executive) agencies, was both broadly apolitical – the proposed reform had cross-party political support – and was grounded in a practical review focusing on establishing appropriate operational arrangements. Although substantially informed by management principles, the approach was essentially inductive.

The New Zealand approach was somewhat different. It too drew on developments in management theory and practice but New Zealand added an important and different dimension; the application of what is now known as the new institutional economics of public choice theory, agent/principal theory and transactions cost theory.

This provided the New Zealand advocates of reform with a powerful theoretical model which could be used to ‘understand’ the incentives facing people involved with public sector management and the structural and other measures which should be put in place to manage or change those incentives.

Public choice theory argues that people generally, whether in the public or the private sector, are inherently self interested and will, when the opportunity presents itself, act opportunistically – in other words seize the opportunity to serve their own self interest rather than the interests of those for whom they work.

Agent/principal theory recognises that virtually all activities of any size are managed by different individuals from those who own or are entitled to the benefit of the activity (in the private sector, the difference is between managers and shareholders; in the public sector it is between public servants and ministers on the one hand and taxpayers on the other). The theory asserts that agents (managers) will have better information than their principals (shareholders; taxpayers) and thus the opportunity to enrich themselves at the expense of their principals. The challenge for agent/principal theorists is how to minimise the risk that agents will act in that way.

In practice, this is seen as a matter of establishing the right sorts of structures and regulatory (including contractual) frameworks. Transactions cost theory recognises that this is not costless. This issue is therefore one of striking a balance between the (assumed) fact that agents will prefer their own interests over those of their principals, where it is possible to do so, with the costs of putting in place measures to minimise that.

Accountability

If a single theme characterises both the diagnosis and the reforms which resulted in New Zealand from applying that theoretical framework, it is accountability – essentially the right to know what has been done on your behalf and the ability to apply sanctions (or rewards) in response.

This seemingly simple statement in practice turns out to have a number of complex components. They include:

- access to clear, relevant and timely information – if you do not know what is happening or has happened, then you cannot respond to it
- clear responsibility on the part of persons being held accountable – if someone does not have clear objectives, then it is difficult to call them to account for failure to deliver. If a manager lacks authority over significant inputs, then he or she has an easy excuse for non-performance. If there are significant conflicts of interest, then people may suppress information flows (hence the classic argument that an organisation with operational responsibilities – say service delivery or regulation – which also has a responsibility for policy advice will use that to suppress advice on alternatives or withhold criticism of the effectiveness of its regulatory or service delivery functions)
- clear and effective means of specifying the objectives of government policy and linking those back to the activities intended to deliver on the objectives -- both before and after.

Accepting the theoretical framework which New Zealand adopted, it was virtually impossible to avoid a comprehensive reform programme. This was particularly the case as there existed a high degree of consensus between senior officials and key cabinet ministers in the new Labour Government (who, whilst in opposition pre-1984, had developed a close relationship with those same officials).

5. WHAT DID WE DO?

I will look at what we did thematically, rather than chronologically, and consider this under the two separate headings of information and structure.

Information

New Zealand had followed the standard public sector practice of cash accounting. Not only is the quality of information which this produces poor; reliance on cash accounting carries with it some quite major problems. For example:

- because it does not include non-cash items, such as depreciation, it can significantly understate the cost of current operations and result in major system problems. As one example, in New Zealand these included a serious run-down in the state of capital equipment and buildings in our hospital system, as hospital managers 'economised' on maintenance and replacement to minimise waiting lists
- similarly, the failure to record contingent liabilities can also understate current expenditure and expose the Government to substantial expense blow-outs. Two examples were the failure to record the present value of future commitments to public sector superannuation, and the long-term liabilities of our Accident Compensation scheme, each of which amounted to several billions of dollars
- by failing to incorporate a cost of capital, cash accounting introduces a distortion into the capital/labour trade-off and typically results in very poor portfolio management – if an asset costs you nothing why worry about it?

The solution was to move to accrual accounting and couple that with a capital charge on government departments. Since 1989 the public sector has been required to report in accordance with generally accepted accounting principles. This applies both to individual

departments, and to the Treasury in its presentation of the public accounts. This incorporates a full balance sheet, including contingent liabilities, an operating statement reflecting the revenue and expenses of the Crown² for that year, a statement of cash flows and a statement of borrowings.

Each department is also required to pay the Treasury a cost of capital on its equity (the difference between assets and liabilities on its balance sheet) which is calculated using a public sector version of the capital asset pricing model.

This part of the New Zealand reforms can really be regarded as an unqualified success. It drew attention to a number of quite serious and deep-seated problems – the hospital, superannuation and accident compensation examples mentioned above were some of these –and provided the incentives to manage capital effectively.

It also made it much more difficult for politicians (or officials) to indulge in the kind of off balance sheet activity which can be tempting when you are pushing expenditure limits. Currently, as an example, my firm is engaged in a major exercise on housing policy. As part of that we have been looking at practice in other countries, including the growth of housing associations in the United Kingdom. These are essentially stand-alone non-profit organisations specialising in the ownership and management of social housing. In England, social housing has traditionally been owned by local authorities but financed by central government which borrows to on-lend to local government. Because of the relationship between central government and local government, that borrowing forms part of the Government's Public Sector Borrowing Requirement.

Over the past decade, housing associations have acquired hundreds of thousands of units of housing from local authorities and built many more. The purchases and construction have been part financed by transfer of government financing but also, quite significantly, by borrowing from the private sector. That borrowing is 'off balance sheet' and is thus additional activity over and above the PSBR limit.

That borrowing is only viable because housing association tenants are entitled to receive the Government's housing benefit. Without that entitlement, no lender would lend. There is an obvious contingent liability but one which is unreported.

A similar practice would not be acceptable in New Zealand. Involvement of third party providers in housing would be determined on its merits rather than as a device to minimise the Government's apparent fiscal exposure³ and any arrangement equivalent to that which supports the private borrowing of housing associations would be reported as a contingent liability.

Structure

In this part of the paper I look first at the approach which was taken to thinking about structural issues, then at some examples of the use of the company structure, which New Zealand has used very extensively, and finally at the core state sector

The objective of structural reform was to create a situation in which managers had clear non-conflicting objectives, the means to achieve those, and an organisational framework which,

² In New Zealand it is conventional to speak of the Crown when referring to the legal entity of the state. This usage is followed in this paper.

³ In fairness, there were other reasons for the increased reliance on housing associations in the UK, including a government concern to provide an alternative to local authorities as a means of delivering housing services.

as far as possible, would generate the appropriate incentives, checks and balances to align the interests of managers (agents) with those of the Crown – the Government (as principal).

Defining The Interests of Government

Giving managers clear non-conflicting objectives required a careful analysis of the different activities undertaken within the public sector in order to identify areas of potential conflict. This analysis established eight different interests of Government which, at least in theory, should be separated one from another. The seven interests are:

- **policy advice.** Here the risk was that if a government agency charged with providing policy advice to ministers also had an implementation role, its policy advice might be biased in favour of that role
- **purchase.** Purchase is the function of specifying and negotiating the price for goods and services the Government requires in order to implement its policies. Under the traditional departmental structure, it was common for the same department to be responsible both for purchasing goods and services and for providing those. Separating out this interest from provision is the so called purchaser/provider split. Its main purpose is to ensure that the department or agency controlling the purchase funds will focus on selecting the best provider rather than favouring its own in-house activities with the objective of purchasing on a least cost basis consistent with performance requirements
- **ownership.** This recognises the Crown's interest as owner of departments and agencies and is seen as broadly similar to the interest of a shareholder in a company. In terms of conflict of interest, the immediate tension is between the Crown's purchase interest in acquiring goods and services from departments or agencies at least cost, and its ownership interest in maintaining or enhancing the value of its investment in its departments and agencies, including not just physical and financial capital but human and intellectual capital as well
- **provision.** This is the other side of the purchaser/provider split. The assumption is that departments or agencies are most likely to focus on making sure that their activities are conducted on a least cost basis and to specification if they are required to negotiate with a separate purchaser rather than handle both functions internally
- **funding.** This recognises that, at least in some situations, the Crown as funder and the Crown as purchaser have separate interests. This will most often arise in areas where the Government faces strong budgetary pressure and wants to ensure that its purchase function is itself subject to strong external discipline. The best example of this in New Zealand is the health sector in which the Ministry of Health acts as the funder, entering into a detailed funding agreement with the Health Funding Authority (the Government's purchase agent), specifying the Government's required health outcomes, and the Health Funding Authority then purchases services from health providers (including public and private hospitals and a wide range of other providers)⁴
- **regulatory.** An often quasi-judicial function overseeing compliance with statute and regulation and undertaking enforcement where appropriate

⁴ Under a current restructuring of the health sector, the Health Funding Authority has been abolished and its functions assumed by the Ministry of Health. The funder/purchaser split is being maintained with the Ministry continuing to act as funder and 21 District Health Boards inheriting the purchase function.

- **monitoring.** The function of overseeing the performance of Crown organisations in order to determine the extent to which they were meeting the Crown's performance requirements of them and if not why not
- **evaluation.** The function of reviewing the effectiveness of government activity. Essentially, this is the process of assessing whether Government is doing the right things as compared with monitoring, the purpose of which is to ensure that government departments and agencies are doing things right.

That was one dimension of the analysis which underlay the structural component of New Zealand's reforms. The second component was one of determining what type of organisational structure was most appropriate for each activity.

Developing Appropriate Structures

The State Services Commission⁵ in a series of reports for Government prepared in 1991 developed the concept of what became known as the three tier state. The tiers were described as:

- the first tier consists of the core agencies that are directly responsible to ministers, carrying out policy advice, administration and regulatory functions. These agencies should be set up in departmental form
- the second tier are those agencies that are owned by the Crown which provide goods and services purchased by (or on behalf of) the core agencies. This tier consists of organisations, legally separate from departments, and established under their own legislation
- the third tier are those organisations from the private sector from which the state purchases goods and services.

This reflected a view that in its productive as opposed to its policy or regulatory functions, the activities of the state had much in common with those of the private market. The overriding objective was to ensure the efficient production of the goods and services which the Crown wished either to purchase or to ensure were provided for third party purchasers. Here, it is possible to see quite a close parallel with the market testing/contracting out approach adopted in the United Kingdom under the *competing for quality* programme launched by the white paper *Competing for Quality/Buying Better Public Services* in 1991.

Under that programme, four 'prior options' questions were asked of an activity:

- whether it needed to be done at all (if not, abolish it)
- whether the Government had to maintain responsibility for it (if not, privatise it)
- if the Government needed to maintain responsibility for it, would the activity be managed more cost effectively by the private or public sector? (If so, put the activity out to private sector competition – statutory contracting out – or invite existing employees to compete with the private sector – market testing)

⁵ The central agency or department responsible for the public service

- if the work had to be carried out within Government, is the organisation properly structured and focused on the task? (The Next Steps principles of clear accountability and delegation should be properly applied).

The New Zealand approach was somewhat different, partly because of issues of timing and a concern to reduce government intervention in the economy. This focused attention on the many trading activities owned by Government, from banks to railways, from television and radio broadcasting to electricity generation and transmission, from postal services and telecommunications to motor vehicle testing and weather forecasting.

Corporatisation – The First of The Structural Reforms

In 1986 the Government passed the State Owned Enterprises Act which provided a statutory framework for establishing government trading enterprises as stand-alone companies. This was designed for government-owned trading activities which operated in markets, both for inputs and for outputs, which were actually or potentially contestable.

The guiding assumption was that if an activity was operating in contestable markets, then the best measure, both of efficiency and of effectiveness, was return on capital. If you could make or exceed a market determined rate of return whilst purchasing your inputs and selling your outputs in competitive markets, then by definition you must be doing a good job both of managing your suppliers and your production functions and of satisfying the needs of consumers or other users.

The model was a simple one. State Owned Enterprises (SOEs) were to have standard company constitutions and be subject to the normal provisions of company law. The SOE Act overlaid a principal objective of being as successful a business as comparable private businesses. This obligation has been interpreted, legally, to mean as profitable as equivalent private businesses. SOE directors are required to prepare what is known as a statement of corporate intent which spells out the principal performance objectives (financial and non-financial) for the SOE, its reporting requirements, its principal areas of business, and the process it would go through in undertaking any major acquisitions or disposals.

The model has been subject to significant refinement. Thus:

- as well as reporting in accordance with generally accepted accounting principles, SOEs are now also required to report in terms of what is known as the value based reporting protocol, which is an economic value-added report identifying the extent to which the business has added or lost value after allowing for the cost of capital
- SOE directors are appointed under a skills-based process run by the Crown Company Monitoring and Advisory Unit (CCMAU). Under this process whenever there is a vacancy on a board CCMAU, in consultation with the board chairman, and the responsible minister, determines a job description and skill requirement for the position, undertakes a conventional director search, often using the assistance of New Zealand's Institute of Directors, and makes a recommendation to the minister. The minister in turn forwards the recommendation to cabinet for approval accompanied by a certificate from the minister that the selection and appointment process has been duly complied with.

This can be seen as another success story from the New Zealand reforms in the sense that what has been established is a robust model for managing government-owned trading interests at arms-length from ministers.⁶

⁶ One qualification to this comment is that we may not have done as much as would be desirable to underpin the robustness of our appointment process. The risk with relying on a certificate from a minister that due process has been complied with is

Emerging lessons from New Zealand's experience include:

- the model is less easy to operate effectively if there are public policy interests over and above merely ensuring efficient operation. A current example is the current Government's concern that Television New Zealand, a State Owned Enterprise which dominates New Zealand's television industry, has been overly focused on revenue generation and has not paid sufficient attention to its responsibilities as a public broadcaster (a scarcely surprising concern from a Government which values public broadcasting, as the previous administration had been focused solely on ensuring that the SOE ran as a successful business)
- it is also clear that the model has some difficulty in dealing with businesses which are natural monopolies or able to exercise a significant degree of monopoly power. To put it another way, simply placing those businesses in the ownership of government companies and putting them under a commercial regime does not do away with the monopoly problem, even if there is agreement on a rate of return which, on the surface, does not include any monopoly rents. This is a current problem in the operation of New Zealand's national grid.

In practice, corporatisation of the Government's major trading activities was followed quite rapidly by significant privatisation.

In most instances, SOEs were privatised through a trade sale, that is sale of 100% of the Government's interest through a competitive bidding process. The Government's advisors argued that this approach would capture maximum value as purchasers would not have to contend with other shareholders – members of the public, or the Government as a residual shareholder - and would have complete freedom to manage the business as they saw fit and access its cash flows.

Other countries, such as Australia, have preferred a staged privatisation of major business assets through partial float. Their objective has been to bring in private sector management, and subject the company to full market disciplines, whilst the Government still retains a substantial shareholding. The objective has been to share in the upside expected to result from change in management. In hindsight, the lesson from comparing these two different approaches is that the decision of whether to use a trade sale or a partial privatisation needs careful assessment on a case by case basis. A trade sale may be the best means in an industry which is stable or possibly declining but partial privatisation may reap much greater rewards for a firm in a growth industry. A number of commentators now see the New Zealand Government's trade sale of its telecommunications company – now Telecom New Zealand Limited – as a major value loss.

Non-SOE Companies – Hospital, Research Institutes And Housing

The company structure was used not only for activities which have a strong market basis such as telecommunications, postal services, banking, broadcasting, forestry and transportation but also for a number of other activities which were somewhat more distant from the market, at least in a New Zealand context. Here I want to speak of just three and draw some lessons which may be particularly important for other countries.

that a minister may decide to flout that process -- or simply not understand its full requirements -- and give a certificate which should not have been issued. In this situation it is difficult for a public servant to protest that his or her minister has given an incorrect certificate. In the United Kingdom, this type of problem has been managed by the establishment of an independent office, the Commissioner for Public Appointments, in order to oversee appointments to public office and with a brief to comment publicly if process is not properly followed. Officials in New Zealand are currently considering recommending to Government that it establish a similar office.

New Zealand reformers saw the company structure, with its emphasis on shareholder value and the statutory and common law framework governing the role of directors, as a potentially valuable tool for driving efficiency gains in a number of areas and for affecting a culture change in areas where it was desired to bring people closer to a market approach. The areas I want to look at are hospitals, research and housing.

Hospitals. New Zealand's public hospitals were seen as being amongst the least efficient parts of the state sector. Until the health reforms of 1993, public hospitals had been managed by statutory boards whose members were a mix of people elected from the board's district and appointed by the Minister of Health. Administration was heavily dominated by medical and nursing interests. Financial management was virtually non-existent – most hospitals had no idea of the value of the assets under their administration or of the condition they were in. It was almost impossible to determine the cost of different procedures and medical staff routinely took decisions on the use of resources solely on clinical grounds with no regard to their actual cost.

Health has always been a major drain on public expenditure. Accordingly, establishing rigorous financial management, including a clear understanding of the costs of different procedures, and of maintaining assets appropriately, was seen as essential both to manage fiscal risk and to ensure a quality health system.

A related issue was the fact that Area Health Boards, as they were known, were effectively bulk funded and thus had substantial discretion over how their funds were used. A further objective of reform was to put in place a robust purchaser/provider split with an external agency contracting with hospitals to purchase a defined mix of services to pre-agreed standards in accordance with the Government's health goals.

The necessary disciplines were seen as broadly those which should apply to a complex business operating in the market (a perception aided by the fact that, internationally, many health systems do have substantial private providers of hospital services – the United States is the obvious example).

The use of a company structure was seen as the appropriate way of imposing commercial disciplines and of signalling to people in the health sector that financial management mattered. With hindsight (and indeed with foresight; I was amongst those warning against the use of company structures) the decision was a most unfortunate one. At the time it was made, the Government was already well advanced with privatising a number of its SOEs. The immediate reaction from health professionals, and much of the public, was that the Government was turning hospitals into companies as a first step in offering them for sale. This was not the case but the damage had been done.

The effect was to undermine, substantially, both public and professional confidence in the reform process. There was an added irony. The strength of the company model lies in the power of return on capital as a measure of efficiency and effectiveness. That, in turn, depends crucially on operating in contestable markets. To a degree, markets for hospital inputs were contestable but the market for outputs was not. Government remained overwhelmingly the principal funder with the Health Funding Authority acting as its purchase agent. In practice, return on capital became almost a measure of the negotiating ability of different hospital companies, rather than a measure of their efficiency or effectiveness.

There is an important lesson here for anyone contemplating the use of a commercial structure. It is that culture matters. The basic problem with the approach taken to reform in New Zealand's hospital sector was that the 'body language' of the company structure – its apparent emphasis on profit rather than service – was in conflict with the values and culture

of those who worked in the system and also ran contrary to public understandings of the nature of New Zealand's government owned and funded health service.

With hindsight, it would have made much better sense for hospitals to be restructured as statutory corporations or foundations and for the desired commercial disciplines to be solely a matter of the purchase agreements between them and the Government's purchase agent.

Research. In New Zealand, government-owned science has for long been the dominant force in research. Part of this has been in the University sector as is common internationally. However the major part of government activity was through two government departments, the Department of Scientific and Industrial Research, and the Ministry of Agriculture. From a reform perspective research was seen as yet another area in which the interests of providers (scientists) had captured a major policy area – the two departments were not only providers; they were also the purchasers as they managed the application of the funds which Government appropriated for research and they were the Government's principal policy advisors on their areas of scientific expertise as well.

In 1992, government-owned science was restructured to create:

- a separate policy ministry, the Ministry of Research, Science and Technology
- a purchase agent, the Foundation for Research, Science and Technology, whose role was to 'purchase' science outputs consistent with government priorities
- a series of stand-alone research institutes formed out of the previous DSIR and the research activities of the Ministry of Agriculture.

Part of the intention of the restructuring was that purchasing should be contestable. The new Crown Research Institutes, as they were known, received some core funding but the majority of Government's funding for research was placed under the control of the Foundation for Research, Science and Technology and, at least in theory, accessible by any person or organisation who wished to bid for it.

The intention was to create a contestable market and, through doing so, to encourage scientists, and their managers, to focus on how best to meet the Government's policy objectives.

With the expectation that they would be operating in contestable markets, the structure selected for Crown Research Institutes was the limited liability company but with some additional statutory obligations reflecting the Crown's long term interests in research. Under their enabling legislation (the Crown Research Institutes Act) 'the purpose of every Crown Research Institute is to undertake research'. A number of principles are set out in the Act including that:

- research....should be undertaken for the benefit of New Zealand
- a Crown Research Institute should pursue excellence in all its activities
- every Crown Research Institute shall, in fulfilling its purpose, operate in a financially responsible manner so that it maintains its financial viability.

Immediately after this restructuring had been completed, the main fund operated by the Foundation for Research, Science and Technology as purchaser was known as the Public Good Science Fund. This reflected a view that governments should only invest in research

which had a strong public good character – in other words research which was not directed to an immediate commercial outcome. One effect of that was to ensure that the great bulk of research funding went to the Crown Research Institutes themselves with the bulk of the remainder going to Universities. Private firms showed little interest in seeking funding for research with no immediate commercial relevance.

Government has subsequently changed its emphasis. There is now a view that, in an economy such as New Zealand's, the main research emphasis should be more towards the applied/innovation end of the spectrum. Research is now expected to have some commercial relevance.

This again places a sharp focus on the rationale behind government use of a company structure and, indeed, continuing government ownership of a series of research institutes intended to have an innovation/commercial focus in their work.

The present situation is an extremely interesting one from a public sector management perspective. It raises quite fundamental questions about whether a government is an appropriate owner of an entity intended to have a commercial/innovative focus in areas which, of their very nature, may involve quite a high degree of risk.

New Zealand governments have been reluctant investors in their companies – typically, they have refused to provide additional capital but instead have been demanding shareholders, extracting as much cash as they can without seriously damaging the business.

With this focus monitoring, and the negotiation of statements of corporate intent, has focused almost solely on financial performance measures. Government has not addressed the public policy reason for retaining ownership of Crown Research Institutes. In a small country an obvious reason is to maintain a critical mass of skills which would not otherwise be present (in a contrast with the New Zealand experience, the British Government, in applying its *Competing for Quality* tests, was quite prepared to privatise a number of research activities but it faced a much lower risk of losing the research talents concerned from the country).

New Zealand now faces a dilemma. Its Crown Research Institutes, if they are to follow the commercial/innovative role required of them, will inevitably need substantial additional capital. They will also need partners - indeed a number of them have already established a variety of joint venture and other relationships. The Government now faces some quite critical issues affecting their future. What are its key policy interests? Minimising government exposure which would see it refusing to provide additional capital and also being reluctant to agree to further expansion of joint venture and related activity? Retaining a critical mass of research skills in areas it judges to be important to the country's future, in which case this should drive the structure, governance and funding of its research institutions? Does it set the Crown Research Institutes free to develop the relationships they see as necessary to grow their businesses – which could amount to privatisation by stealth (as it would almost certainly result in the bulk of their research activity and resultant intellectual property ending up in the hands of joint ventures with private sector partners)?

More fundamentally, is a government, with its processes of public accountability, and necessarily complicated decision-making processes, suited to own what it may now wish to see operate as relatively entrepreneurial businesses?

I have spent some time on this example as I believe that it is an illustration of the kind of problem which governments of whatever character will increasingly face; the probability that one consequence of restructuring government activity along market lines may be to make it inevitable that, whether the Government likes it or not, the restructured activity will gravitate into the market, and eventually out of government ownership and control, whether or not

Government has any intention that should happen. The only alternative may be to accept the loss of the entity in a different way, through gradual attrition. Certainly, it seems clear with New Zealand's Crown Research Institutes, that if they cannot continue to grow in accordance with the logic of their new role, then they will lose substantial numbers of their staff and with it much of New Zealand's research capability.

Housing. New Zealanders have a strong attachment to the ideal of owning their own home and we have a home ownership rate which is relatively high by world standards. When we began our major programme of public sector reform, we had more than 50 years experience of central government involvement in assisting access to housing by households of limited means. For most of that time the primary emphasis had been on providing low interest mortgages to help qualifying households achieve home ownership. At the same time, the Government was also by far the country's largest residential landlord owning, by the early 1990s, approximately 70,000 units which were rented to households who satisfied needs based tests for eligibility at a rental assessed as 25% of income.

A statutory corporation, the Housing Corporation of New Zealand, was the Government's instrument both for implementing its mortgage assistance and rental housing programmes and for acting as its principal policy advisor. Although it had its own separate board, and legal identity, in many respects it operated more as a government department than as a conventional corporate.

The basis of the Government's housing assistance policies came under intense debate in the late 1980s. Officials, especially from the Treasury, argued that the existing policies were both inefficient and inequitable. In their view, to the extent that people could not afford to meet their housing needs through the market, the problem should be seen as one of insufficient income and dealt with through income support policy. The problems they identified with direct provision included:

- Low interest loans discriminated between people who wished to purchase housing and people, in similar financial circumstances, who preferred to rent
- The Government's stock of rental housing was sufficient to accommodate only about 20% of low income households who could not afford to purchase their own housing. As a result, Government was creating a privileged class amongst low income households as its tenants had access to housing services at a much lower cost than their equivalents in the private market
- On the other hand, state housing tenants were denied much of the freedom of choice which other households had over the nature, quality and location of their housing.

Finally, in 1992, these arguments were accepted by the then government. It took a series of decisions including:

- Abolishing the income related rental policy for state housing and replacing it with a market rental policy
- Abolishing low interest loans (other than for certain limited categories)
- Providing assistance to low income households through a means tested income support measure known as the Accommodation Supplement available regardless of housing tenure
- Selling the Government's portfolio of low interest mortgages to the private sector

- Corporatising its state housing stock.

Corporatisation reflected the then Government's view that, with a shift to income support, management of its housing portfolio was primarily a commercial undertaking which should have a primary objective of maximising its value in the interests of the Government as shareholder. The result was the incorporation of a Crown-owned company, Housing New Zealand Limited (HNZ), with a commercial Board of Directors and a commercial balance sheet (as a deliberate government policy, HNZ was required to raise debt up to commercially prudent levels and pay that to the Government as a special dividend).

This corporatisation was quite controversial. A number of people, including most social agencies which had anything to do with housing, were quite bitterly opposed to it, especially as HNZ started to "rationalise" its portfolio, something which it did to improve its rate of return on investment. Before corporatisation, the Government had owned quite large numbers of houses in what were now relatively attractive and high priced housing areas (the houses had often been built before the areas improved in status). Even under a market rental approach, HNZ found it could not charge rentals anywhere near the level needed to earn its required return. Its shareholder value objective put pressure on it to sell these properties and reinvest in new housing but in less favoured areas, a policy which was seen as amounting to driving poorer households into ghettos.

More generally, the primarily commercial approach to management of HNZ was seen as inconsistent with New Zealand's tradition, which had applied regardless of which party was in Government, of looking after the least well off members of the community. This was the case even though HNZ 's statement of corporate intent included a reference to social objectives in a mission statement which reads:

"To facilitate access to rental accommodation for those in greatest need with such services to be provided in a manner that enhances Shareholder value and contributes to the Crown's social objectives".

In practice HNZ was seen as acting as a commercial landlord with social objectives taking second place. This coincided with a shifting attitude in the wider community towards the nature of housing provision which increasingly sees this as being much more than just the physical house itself. Instead, the way in which access to housing is managed is seen as a critical factor in the ability to deliver other social services effectively. Amongst other things, the emerging view in New Zealand (and in countries like the United Kingdom) is that unless households have access to stable affordable and appropriate housing, it will be difficult to maintain necessary linkages to other social service facilities.

Against this way of thinking about housing, the shift to a purely or primarily commercial attitude on the part of HNZ was seen as working directly against the Government's interest in ensuring access to adequate education, employment, and health care for the least well off members of the community with the risk, to Government, of incurring much higher social and public health costs as a consequence.

The change of government has seen a marked shift in policy. HNZ is being re-tasked in the short-term to focus more on need. On 1 December 2000 the market rental policy was replaced with a return to an income related rental policy (which will again create differential treatment of low income households in similar financial circumstances depending solely on who the landlord happens to be -- other low income households will continue to be eligible for the Accommodation Supplement but the effective assistance which it delivers is significantly less).

At the same time, the Government is restructuring its housing agencies. HNZ will remain in existence but purely as a legal entity owning housing stock and holding the related liabilities. Staff will be transferred to a revived Housing Corporation which will again become the Government's principal advisor on housing policy (reversing the policy/purchaser/providers split which lay behind the earlier restructuring).

The principal lesson to draw from this experience is, once again, the importance of having regard to community understandings and being satisfied that the measures you wish to put in place, and the way in which they are implemented, are accepted by your public as legitimate. This was never case with the New Zealand government's housing reforms, despite the apparent force of the underlying argument that meeting housing need was primarily a matter of income support and that direct provision would inevitably create a privileged class amongst low income groups.

The Core State Sector

The theoretical framework guiding reform of the New Zealand public sector pointed to structural arrangements for core government departments which ideally would result in organisations with single rather than multiple functions (eg separate organisations for policy, purchase, provision) whose managers had authority to manage – including discretion over choice of inputs – and who could be held properly accountable for their performance

Part of this involved stripping out from the core state sector most activities which were primarily operational in nature and establishing them as stand alone entities. There were some parallels with the UK “Next Steps” approach but some important differences. In the UK, Next Step agencies remain directly responsible to a minister, their staff are still members of the civil service, and they remain legally an indivisible part of the Crown.

New Zealand adopted a different approach. Operational agencies removed from a departmental structure were placed in entities which had their own separate legal identity (although remaining crown owned) and whose staff were no longer public servants. The organisational form chosen varied depending on the nature of the activity. As we have seen, research was placed in a series of crown owned companies. In other cases entities were structured as what we term statutory corporations – entities with their own separate legal and corporate identity, established by Act of Parliament, and limited to the purposes set out under their Act. The safety and regulatory activities which were formerly part of our Ministry of Transport are an example of activities which were treated in this way. The result is a series of safety authorities each with its own legal identity and separate board operating with a substantial degree of autonomy.

The legal framework for restructuring the core state sector was set out in the State Sector Act 1988 which provides that each department shall have as its administrative head a Chief Executive and that the Chief Executive shall be responsible to the appropriate minister for:

- a) The carrying out of the functions and duties of the department (including those imposed by Act or by the policies of the Government);
- b) The tendering of advice to the appropriate minister and other ministers of the Crown;
- c) The general conduct of the department;
- d) The efficient, effective and economical management of the activities of the department.

The independence of the Chief Executive is stressed in a provision relating to employees which states that “in matters relating to decisions on individual employees (whether matters relating to the appointment, promotion, demotion, transfer, disciplining, or the cessation of

the employment of any employee, or other matters), the Chief Executive of a department shall not be responsible to the appropriate minister but shall act independently.” The Act also provides that “the Chief Executive of a department shall have the powers necessary to carry out the functions, responsibilities, and duties imposed on that Chief Executive by or under this Act, as well as the powers necessary to carry out the functions, responsibilities, and duties imposed on that Chief Executive or that department by or under any other Act.”

Previously, the State Services Commission had been the employer of all public servants and responsible for setting their terms and conditions of employment, including recruitment and promotion. Although on a day to day basis much of this was delegated to departmental heads, the practical effect was that the Commission rather than departmental heads controlled the staffing resource including determining what mix of skills a department could employ.

In parallel with this, resources were appropriated by Parliament on an input basis and this was supported by a detailed set of controls, known as Treasury Instructions, providing for quite micro level approval of individual expenditures.

The new approach was intended, quite deliberately, to give Chief Executives a much greater degree of freedom (the very term itself signalled that their role was now much more akin to that of a Chief Executive in the private sector; prior to the Act they had been formally known as Permanent Heads)

Chief Executives now had the freedom to employ their own staff and set the terms and conditions on which to do so. At the same time, departmental resourcing shifted from input budgeting to output budgeting. Here the intention was to give Chief Executives discretion over the mix of inputs which they purchased in order to deliver Government’s required outputs.

These measures on the input side were seen as essential if Chief Executives were to be held properly accountable for performance. The reform emphasis on “Letting the Managers Manage” recognised that, to the extent Chief Executives lacked discretion over their input mix, any shortcomings in departmental performance could easily be blamed on that lack of discretion thus undermining effective accountability.

Setting the contractual framework. With greater autonomy came greater accountability – indeed the purpose of the restructuring was primarily to get better accountability for public sector performance. In the New Zealand model, the Crown has two primary interests in any department. These are:

- the ownership interest – maintenance of the capability and resources of the department – expressed in current guidelines for Chief Executive performance measurement as “the department’s capability is maximised to meet current and future demands efficiently and effectively”
- the purchase interest – the Crown’s interest in acquiring departmental outputs on a least cost basis and in accordance with agreed specifications in order to contribute to the Crown’s desired outcomes.

Each of these two interests is the subject of a contract between the Chief Executive and the appropriate minister. The contract dealing with the Crown’s ownership interest, known as the

Chief Executive's performance agreement, is with what is described as the responsible minister⁷

A separate contract, known as the purchase agreement, will be entered into between the Chief Executive and the minister for each vote for which the department has responsibility. That contract will specify the outputs which the department is expected to produce and will include pricing and performance specifications.

The model is also based on the assumption that decisions about outcomes (and responsibility for them) should rest with ministers, and not with officials. The logic behind this is that decisions about outcomes are essentially political decisions – in any society the range of potential outcomes, government services etc. is almost limitless. The role of the Government is to choose amongst a range of competing ends, decide on those it wishes to pursue, and task its bureaucracy accordingly.

This is recognised in the provisions of the Public Finance Act dealing with the Government's Estimates of Expenditure. Each vote minister is responsible for the contents of the estimates for his or her vote. One of the matters which must be included is a statement of "the link between the classes of outputs to be purchased by the Crown and the Government's desired outcomes". The resultant structure was conceptually simple and apparently uncluttered with what seemed to be a strong basis for clarity of performance and accountability.

We have been learning that life is not quite so simple. There have been some real gains from these structural reforms but also some lessons including some unanticipated and potentially serious consequences.

First, the gains. I will be brief on these as the main purpose of this presentation is to highlight lessons from our experience for public sector reformers elsewhere. The new approach has unquestionably contributed to improved efficiency within the public sector and sharpened the focus on the Crown's different interests. There is now much less risk, for example, than under the previous structure that policy advice will be biased in favour of in-house providers.

⁷ Some departments have responsibility for one vote only. In this case the vote minister is the responsible minister; a number of departments administer more than one vote; in this case the responsible minister will be one of the vote ministers, normally the minister whose vote is the most significant amongst those which the department manages.

6. LESSONS FROM THE NEW ZEALAND EXPERIENCE

What about the lessons? We moved from a centrally controlled public service, quite closely integrated in its workings, to a much more dis-aggregated system. By sharpening our focus on who was responsible for what, we changed both incentives and behaviour and generally narrowed the focus. In this part of this presentation, I want to look at the following areas where I consider that an understanding of the New Zealand experience will be of particular value to reformers elsewhere. They are:

- Focus
- The Collective Interest of Government
- Capability
- Succession Planning
- Public Sector Ethos
- The output/outcome relationship

Focus

The new model concentrates the attention of Chief Executives and their staff on the outputs included in the department's purchase agreement (or agreements if it operates through more than one vote). This has narrowed the focus of the typical department, as compared with the pre-reform public service in two ways:

- It has clearly delineated the areas on which a department should focus and, by exclusion, the areas on which it should not
- The contractual emphasis on producing outputs, conventionally within the current fiscal year, has shifted attention away from the impacts of departmental activity towards the specifics of the outputs covered by the purchase agreement

There is at least a suggestion that this has resulted in a much narrower approach to policy advice. Advisors now focus on the outputs for which their department is responsible rather than, as was previously the case, more broadly on the impacts of government activity. This has been compounded by the separation of policy advice from other functions. We appear to have protected ourselves against the risk of conflict of interest, through bundling different functions within one department, at the cost of some loss of understanding. Previously, policy advisors in most areas of government activity worked alongside the people who had responsibility for implementation. Typically, advisors and implementors are now in separate departments, often with a tension between them (as departments with implementation responsibility see policy departments almost in the nature of the enemy, with a brief to interfere in their activity). Both this potentially adversarial relationship and the distancing of policy advisors from implementation, has made it more difficult for policy advice to be directly informed by experience "in the field" from those responsible for implementing policy.

The Collective Interest of Government

Associated with the previous issue, is a concern that the reforms have broken down the strength of public sector understanding of and commitment to the collective interest of Government. It is not uncommon for government departments or agencies to act as though they were direct competitors and to see their role as serving the interests of their minister rather than (and sometimes in opposition to) the interests of Government as a whole.

Partly this is because we have not paid sufficient attention to maintaining formal and informal linkages across Government. In New Zealand, departmental Chief Executives meet infrequently as a group and often more in the nature of a trade association, to consider operational issues of mutual concern, rather than to focus on the collective interest of Government.

This contrasts markedly, for example, with the UK situation in which Chief Executives meet on a weekly basis for the explicit purpose of maintaining liaison and sharing information on issues which go to the collective interest of Government rather than to the interests of a single department or minister. One New Zealander who recently moved to a Chief Executive role in the UK civil service from an equivalent position in New Zealand has commented informally on the extraordinary difference which this single mechanism for coordination makes to the working of individual departments in the UK as opposed to New Zealand.

This is a problem which successive governments have attempted to address by putting in place high level strategic goals which they expect to see reflected in the purchase agreements of individual departments and to result in a better strategic focus on the collective interest. In practice, these strategic goals have been expressed at such a high level that they have lacked the precision required to drive greater co-ordination at a departmental level.

In 1998, after several years of experience of this approach, the then National Government introduced a system of Ministerial Teams for each of the Government's strategic goals, with a direction that the Ministers should focus on coordination. Some progress was made, but this experiment was abandoned by the change of Government.

An assessment of the New Zealand experience suggests that informal mechanisms, especially ones which have the effect of creating a sense of membership of a group with a common purpose, may be a necessary part of maintaining a sense that individual departments are part of a collective whole and that ultimately their purpose is to serve Government rather than an individual minister.

Capability – the conflict between the Government's purchase and ownership interests

As we have seen, the Chief Executive's performance agreement requires that he or she maximise the department's capability to meet current and future demands efficiently and effectively.

There is, in practice, very real concern that this has not been achieved; that capability in this sense is at risk in a number of departments.

The immediate cause has been the interplay between the Government's purchase and ownership interests. Departments receive their funding (other than capital injections) from

the payments they receive for the provision of outputs. Although in theory under the New Zealand model, Chief Executives have discretion as to the mix of inputs they will use to produce the outputs they are contracted to provide, in practice this discretion is quite strongly limited by the way in which Government allocates resources. Moneys are appropriated in the estimates by Parliament, against a minister's statement of the resources he or she requires to purchase outputs. For at least the past ten years, successive New Zealand governments have run a quite tight fiscal policy, part of which has been firm control over expenditure. One prominent feature of this has been the scrutiny of bids for output funding. Departments are required to provide detailed costings in support of output funding bids. Essentially, they are required to justify the mix and costs of inputs they will use.

In a tight fiscal environment, the pressure is on departments to provide the maximum amount of output at a minimum cost. In New Zealand this pressure has been reinforced by an assumption (not supported by any empirical evidence) that a well-run department should be able to increase its productivity in the order of 3% per annum as the benefits as such things as an increased use of information technology come to bear. As a result, departments, especially ones operating in areas such as policy advice, have been expected to reduce the real unit cost of their outputs, year on year.

One consequence has been for departments to cut back on "discretionary" spending such as staff development. There has been a growing tendency for departments to prefer to recruit experienced staff rather than new graduates whom they will then train. There has also been a marked reluctance to invest in further training for existing staff.

In areas where the state is the major employer, such as policy advice and analysis, the principal source from which a department can recruit experienced staff is other departments. This has been happening to an increasing degree, contributing to very real concerns that departmental capability, overall, is under threat.

Again, this marks a change from the pre-reform situation. Then, the State Service Commission, as the employer, had the responsibility for staff development throughout the public service. It ran a dedicated budget for this purpose, which was allocated to individual departments in accordance with their perceived training needs. The effect of this structure was to protect the training investment against the effects of expenditure controls on individual departments.

Another consequence appears to be an increase in work place stress and reduced morale as staff cope with the impact of a purchase interest driven squeeze on resources. In a 1998 paper the State Service Commission stated "A number of departments display evidence of a high level of stress in terms of work-place relations and effective performance. They demonstrate low morale, employee dissatisfaction, and tensions between managers and staff, and between local and national units. Some of this is an inevitable consequence of sustained pressure for performance improvement and cost control, but it may also be symptomatic of other things, such as cumulative under-investment in skills and technology and unrealistic output volumes and prices." (State Services Commission, 1998a)

The practical reality is that the Crown has allowed its purchase interest to dominate its ownership interest. This must be a very real risk in any system which adopts a rigorous "purchase" based approach to government expenditure. In theory, in a purchase relationship which is intended to be a multi-year one, the purchase price should include a margin for investment in future capability – as the purchase price is the only source which the provider has from which to finance this and the purchaser has a clear vested interest in that future capability. However, it is in practice remarkably difficult to quantify the investment required, or the consequences of failing to invest.

This was recognised by the then Minister of State Services, the Hon. Simon Upton when he announced in September 1999 that the State Service Commission would be required to focus more specifically on the Crown's ownership interest. In support of the changed emphasis he noted the "what Parliament and the public needs is an assurance that government departments will be able to deliver in the future and that proper attention is being paid to non-financial matters such as skills, information technology, management and ethics"

This is a problem which could have been foreseen but which was really brushed aside by the almost single-minded focus on expenditure control. Other jurisdictions looking at a similar purchase and ownership split will be well advised to ensure that, at the time of implementing the split, specific measures are put in place to secure the desired level of capability within government departments and that these are ring-fenced against other demands – specifically, that resources committed to the ownership interest cannot be diverted to fund purchase related activity.

Succession Planning

Pre-reform, the State Services Commission as the employer of all public servants, had the unequivocal responsibility for succession planning within the public service. As employer, it also had knowledge of the skills and capabilities of middle and senior management.

This was reinforced by two other factors, one formal and one informal:

- The career service status of the public service was protected by a statutory provision to the effect that outsiders could only be appointed to a position in the public service if they had "clearly more merit" than any internal applicant; this provision was supported by an appeal process which effectively discouraged outside applicants, simply because of the time taken to hear any appeal.
- The much closer relationship between permanent heads resulted in an informal, but very effective, process of identifying potential leaders and ensuring that they received appropriate career advice, training and experience.

The reforms removed these structural supports for succession planning. They actually went further. The preference for internal applicants was removed; there was a clear intention that senior positions in the public sector should not only be contested by outside applicants but that, over time, an increasing proportion of senior appointees would come from outside the public service. This expectation played a part in lessening the emphasis on planning succession within the public service itself.

Despite the belief that the public service was moving from being a relatively exclusive life-long career to just another competitor in the labour market for management skills, it was recognised that some attempt should be made to provide within the service a group of people who could be seen as candidates for Chief Executive roles. This was created, under the State Sector Act, as the Senior Executive Service. A number of senior positions, in each department, were designated as part of this service, but the on-going support in terms of development and training, and building a sense of ethos across the group never eventuated. Instead SES status simply became the threshold for an additional set of employment related benefits (such as an employer-provided car, something which had not previously been a feature of the public service).

This is in marked contrast with the United Kingdom. As part of its reforms, the UK Government established what is known as the Senior Civil Service, approximately 3,000 senior positions across departments and executive agencies, whose members are employed on common terms and conditions and managed as an across service resource.

New Zealand now faces a significant problem of Chief Executive succession. Individual Chief Executives have not, for the most part, put significant effort into succession planning within their own departments (partly as a consequence of the emphasis on the purchase rather than the ownership interest which was discussed above). The expected interest from external applicants has not really eventuated. Two reasons at least explain this:

- The gap between public and private sector salaries, at the Chief Executive level, has gradually widened in favour of the private sector. This has been coupled with a growing perception that the role of a public service Chief Executive has significant drawbacks, including a growing propensity for individuals to be subject to media and/or political attack.
- In practice, appointments of private sector candidates have not worked out as expected. Specifically, it has become clear that it is very hard to be a successful public sector Chief Executive without significant prior experience of working with the political process.

The lesson? Succession planning matters and in a disaggregated public sector is one of the key functions which should remain the responsibility of a central agency, not necessarily in a directive fashion, but certainly in an enabling and resourcing one.

Public Service Ethos

Here, the question is how well New Zealand has been able to maintain the commitment to public service as a vocation. Whatever the faults of the pre-reform system, it would be generally agreed that there was a strong sense of service within the public sector. People made a commitment to a lifetime career in part because of the security which it offered but also because of the attraction of working for the common good.

Arguably, this sense of commitment was an important part of self-regulation. Public servants, by and large, could be depended upon to perform not just because of external rewards but because of a sense that what they were doing served a useful public purpose. To a degree this may have reflected the strong egalitarian culture which characterised New Zealand for much of the 20th-century.

There is a very real concern that we may have lost much of the former spirit of service and the commitment which went with it in the shift to a contractually based rather than a service based culture. The core assumptions of the public choice and agent/principal theories, that individuals are inherently self-interested and will act opportunistically unless constrained from doing so, can be seen as a recipe for distrust. One academic commentator has recently noted that "Agency theory's founding assumption that all individuals are self-interested utility maximisers becomes something of a self-fulfilling prophecy. Mistrust fosters more mistrust."

This is more than just an academic quibble. Despite the detailed contractualism of the New Zealand system, we still face quite major problems in measuring performance. Most outputs which departments produce have no direct private sector equivalent. Developing appropriate benchmarks for measuring efficiency and effectiveness is extraordinarily difficult. To the extent that performance cannot be accurately measured, then, like it or not, Government is forced to rely on the integrity and commitment of its public servants. To put it another way, in much of the public service, despite the contractual basis, optimal performance may still depend on trust and commitment. If this is the case, then Government may be putting its most important control mechanism, the integrity and professionalism of its public servants, at risk by basing its relationship with them on a theoretical model build on what amounts to an assumption of mistrust.

This is certainly something which other public sector reformers, looking at the strengths and weaknesses of the public choice model, should bear in mind. One possibility would be to apply a relational contracting model, such as is employed in the private sector between contracting parties who see trust as the essence of their relationship. The particular requirements of public sector accountability may make this a difficult undertaking.

A number of other changes have also impacted on the public service ethos. I want to highlight one. This is what one observer has called "false customisation" -- the practice of treating people who deal with a department as "customers". There is anecdotal evidence to suggest that this has been a significant contributor to falling public confidence in Government. The plain truth is that most people want to be treated as citizens rather than as customers.

The practice appears to give offence for at least two reasons. The first is that the status of citizen carries with it more and deeper meaning than the status of customer. To be a citizen is part of your identity. To be a customer is part of a transaction.

The second reason is the inherent nonsense of the term in many of the dealings which people have with departments. For example, Is a taxpayer a customer of a tax department with that term's implication of voluntarily entering into a relationship of mutual benefit? The answer is no and the attempt, in New Zealand, to treat taxpayers as customers has backfired quite badly.

What seems to matter is that people do think of themselves as citizens and want the agencies of the state with whom they deal to recognise and respect that status. I would certainly advise other reformers to ensure that, in the urge to be efficient and "customer friendly", they take care to respect the understandings within their own society and culture of the nature and role of government and of what is expected in its relationship to its citizens.

The Output/Outcome Relationship

The relationship between outputs and outcomes lies at the heart of the role of government. In essence, all governments exist in order to change outcomes from what they would be in the absence of government intervention. This both emphasises the inherently political nature of outcomes -- they are about choices which citizens make and express through their governing structures⁸ -- and the inherent reliance on the outputs which the public service provides (and in this respect, even market or other third party provision will normally come within the scope of public service provision simply because of the policy and other functions which will underpin external provision).

The output/outcome relationship has been the least satisfactory part of the New Zealand reforms. The model we adopted drew a very clear separation between chief executive (and through him or her departmental or agency) responsibility for outputs and ministerial -- political -- responsibility for outcomes. The expectation was that ministers would act as intelligent purchasers of outputs which they judged were appropriate to deliver the outcomes they required and that ministers would also accept parliamentary (public) accountability for outcome effectiveness.

⁸ Arguably, this is true regardless of the nature of the governing structure. In some societies, the relationship is immediate and direct with citizen involvement in elections or referenda. At one extreme is the example of Switzerland's direct democracy with its heavy reliance on citizen decision-making through referenda. At another extreme is a society such as the former Soviet Union where decision-making appeared to be centralized and out of the reach of the ordinary citizen. However, even that governing structure proved ultimately subject to citizen attitudes as it lost legitimacy.

The Statutory Framework

The distinction between the responsibilities of chief executives and ministers was spelt out clearly by the then Controller and Auditor-General in his submission to the parliamentary select committee considering the Public Finance Bill (which became The Public Finance Act 1989), as was his concern that there was no provision in the Bill for holding ministers accountable. He had this to say:

"One of the key concepts embodied in the proposed reforms is the distinction between outputs (the goods or services produced by a department or Crown agency) and outcomes (the effect on the community of the outputs produced). The significance of this distinction only becomes clear when it is recognised that Chief Executives are to be responsible and accountable for outputs only. This is, in our view, appropriate, and is a principle that permeates many clauses in the Bill. Outcomes, and the effect that outputs have on these, are the responsibility of Ministers. There is, however, no provision made in the Bill for Ministerial reporting on outcomes. This is a significant omission in what is otherwise a well structured set of accountability and reporting provisions."

The New Zealand Treasury, as the principal architect of the reforms, set out its views in a December 1998 circular to chief executives as:

"Ministers are the link between the Government and agencies. Collectively they are accountable for the performance of the Government as a whole, and individually they are accountable for the performance of their particular agency.

"It is proposed that Ministers prepare an annual report on their activities. The annual reports of an agency should be prepared in terms of the activities for which the Chief Executive is responsible, and presented to the Minister. The Minister should then prepare a further brief report and present both reports to Parliament. This process would recognise the responsibilities of Ministers with regard to resource usage. That is, Ministers would select target outcomes, assign priorities to those outcomes, and identify particular outputs to achieve outcomes. The current system of reporting, whereby the agency's report is tabled in the House, confuses the responsibilities of the Chief Executive and those of the Minister." (The Treasury, 1988)

The Public Finance Act itself was passed without any explicit mechanism for outcome accountability. Instead, the only reference to outcomes was a requirement that the Estimates for a Vote should include "the link between each class of outputs and the Government's desired outcomes".

Officials expected that, because the Estimates are essentially a ministerial document - the basis on which the Minister seeks from Parliament the appropriation for his or her Vote - Ministers would take a close interest in the output/outcome link. In practice it seems that these statements were typically prepared by officials with little or no ministerial involvement and with no great depth of analysis. In reviewing this behaviour, officials concluded that a principal reason for the lack of ministerial interest was the requirement to prepare outcome statements for each output class with the probability that, as they were buried at the output class level, they would be seen as a natural part of the officials' task of preparing the draft Estimates. The solution was seen to be shifting the statements from individual output classes and instead giving them greater status as a separate stand-alone component at the beginning of the Vote. To achieve this, as part of 1994 amendments to the Act regarding the format of the Estimates, the requirement to state the output/outcome linkage was rephrased

as "identify the link between the classes of outputs to be purchased by the Crown and the Government's desired outcomes".

Again, the Treasury spelt out its expectations to departments. In a December 1994 booklet "Approved Format of the 1995/96 Estimates and Departmental Forecast Reports" it had this to say:

"Part A1 should comprise a statement by the Vote Minister to Parliament of how the appropriations sought will contribute to the Government's objectives. It should therefore be outcome related. Relevant sources at present include the Government's "*Path to 2010*", "*The Next 3 Years*" and strategic result areas (SRAs). (The Treasury, 1994)

The booklet made it quite explicit that what was required was a statement *by the Minister* to Parliament. The context was a set of assumptions about the constitutional responsibility for seeking and granting appropriations. It is for the Minister, not the Department, to seek the appropriation and provide the necessary justification. It is for Parliament, in its discretion, to determine whether or not to grant the appropriation. In making that determination, the constitutional assumption is that Parliament will pay due regard to the expected results (outcomes) from making the appropriation and will look to the Minister to satisfy it that the appropriation is justified.

This initiative also failed to achieve the desired result. In practice, the expectation that Ministers would be to be prepared to accept outcome accountability and actively ensure that they played their part was fatally flawed. The political incentives on Ministers are to take credit for success, and avoid blame for failure, in each case regardless of whether in practice they were responsible or not. Inviting Ministers to accept outcome accountability in advance of the outcomes occurring, was inviting them to give away any possibility of managing the political consequences for themselves of the results of future government activity in their area of responsibility.

Current Concerns

The result has been to leave us with at least two ongoing problems in public sector management. The first is a continuing and serious gap in public sector accountability. In 1999 the Controller and Auditor-General in his third report for 1999, "The Accountability of Executive Government To Parliament", expressed a number of concerns regarding the way in which outcome information is presented to Parliament. These included vagueness, the lack of any requirement to measure and report on actual outcomes and the common failure to support assertions of linkages between outputs and outcomes with any empirical information or research.

Last year two senior members of the Audit Office, in a contribution to an international public management workshop looking at experience with New Zealand's reforms noted:

"The Public Finance Act does not say how outcomes are to be specified or measured, nor does it require any indication of their strategic priority. Nor is there any requirement to report what outcomes have occurred, with an explanation of how they compared with the intended outcomes.

"Parliament needs to know whether or not those outcomes are actually being achieved and whether the spending is effective. More useful information about outcomes would be made available by:

- requiring governments to present a more prioritised set of outcome statements as part of the Estimates

- requiring those outcome statements to be underpinned by statements that set out how the outcomes will be measured, and
- requiring that outcomes actually be measured, and the impact of the outputs purchased by the Crown be evaluated.”

Government itself experimented with ways of achieving a better integration between departmental outputs and its desired outcomes. The first approach was to establish a series of Strategic Result Areas (SRAs) which were high level statements of objectives for significant policy areas. Departments, in negotiating purchase agreements, were required to set out Key Result Areas (KRAs) intended to link into and demonstrate how they would contribute to achieving Strategic Results. As noted earlier in this paper, this approach was ineffectual, primarily because it proved difficult to link the high level general statements in SRAs with specific output activity. There was a tendency for departments, when setting their KRAs simply to assert, without any supporting justification, that they would contribute to specific SRAs.

In practice, although this initiative was formally directed at achieving better integration of government policy by default it also became, at least from the government's perspective, something of a substitute for formal and effective arrangements for parliamentary accountability. Thus, the Controller and Auditor General, in his 1999 Report cited above, noted of the SRA/KRA initiative, “However, although it was first designed as a tool to be used largely *within* the Executive, it seems to us to have also been used as a substitute remedy for problems with the current accountability regime that perhaps should be corrected more formally.” (Controller and Auditor General, 1999)

The point expressed here, although put in quite gentle terms, is fundamental to the type of public management system which New Zealand operates. Constitutionally, the central point of that system is parliamentary accountability. It is Parliament which appropriates monies for Government's expenditure needs and it is Parliament which holds ministers individually, and the Executive as a whole, accountable for the way in which those monies are spent and the results which are achieved. Without clear statements, in advance, of the outcomes expected, and reporting are to the event of the outcomes which were achieved, parliamentary accountability is seriously compromised.

The second problem is the relative lack of focus by officials themselves on the outcomes which might or should result from the outputs which they are contracted to deliver. Although this can be a bad enough problem for outcomes which are within the area of activity of an individual department, it is magnified when desired outcomes require the coordinated outputs of more than one department. Because officials are required to focus on outputs and have no formal responsibility for the outcomes to which they contribute, we may be at risk of creating what is almost a system bias against developing what the UK Government describes as “joined up” policy.

A review undertaken for the Treasury in 1999 on outcomes of the current public management system notes that “one other commonly expressed concern about service delivery is what has been termed the ‘silo effect’. This refers to a perception that, in rigorously pursuing the delivery of outputs negotiated vertically agency by agency, some important cross agency and cross-sectoral dimensions were lost sight of (Schick, 1996, and Schick, 1999).

They went to say, in looking at outstanding issues, “there is a broad consensus that a key weakness in the current regime is the lack of information on the effectiveness of the public sector. In essence, the current regime may be reasonably efficient in producing outputs, but the outputs may be the wrong ones. This suggests that a priority for effort should be assessing the current state of capability of the system in this regard, and investigating promising approaches that could improve capability in a cost-effective manner.”

These findings reflect concerns which had also been expressed by ministers. In an address to the 1997 Public Sector Senior Managers Conference, the then Minister of State Services (and subsequently national party Prime Minister), the Hon Jenny Shipley, had this to say:

“It is important for the State sector to remember that a major object in separating policy functions from service delivery, and in setting up specialist sectoral policy ministries, was to sharpen the focus, quality and impact of advisory work. I would say, judging from what I have observed both at the Cabinet table and out in the front lines, that to date this has not yet been an overwhelming success. Policy and outcomes are connected. I leave that challenge with you.”

Recognising the problems with the SRA approach, Government moved in 1998 to replace that with a system of Strategic Policies and Overarching Goals organised around ministerial teams, the objective being to facilitate cross-departmental working on Government's major priorities and to put ministers in the driving seat. The change of government in late 1999 put an end to this approach before it had been properly tested.

The State Services Commission addressed broadly the same question in an occasional paper which it published late in 1999 (State Services Commission, 1999) after consultation with departments on proposals to improve the Government's strategic management system. That paper highlighted the continuing commitment within the public sector to the separation of responsibility for outputs and outcomes in a way which suggested that it may have become quite ingrained whilst also signalling that the Commission itself recognised the need to find a way of resolving this problem. The following extract makes the point:

“During consultation, some concern was expressed that the proposals should not lead to a shift in the focus of departmental accountability away from outputs to outcomes. The SSC accepts that departments are only accountable for outputs under the Public Finance Act, and considers that the changes to the strategic management system reflect a shift towards more of a partnership between Ministers and Chief Executives in relation to the responsibility for outcomes. The requirement for Chief Executives to establish the intervention logic between KRAs and strategic priorities (outputs and outcomes) is a possible illustration of this shift.”

How is the New Zealand public sector currently seeking to address the problem of output/outcome linkage? Not by recognising, formally or informally, that departments accept some form of outcome responsibility but by developing a concept and practice described as intervention analysis. This was described earlier this year by a senior treasury official in the following terms:

"Intervention analysis is the core business of policy agencies, and an important part of the business of many operational agencies as well. It needs to be done well if governments are to have any chance of reaching their outcome aspirations.

“Intervention analysis involves bringing analytical tools and theoretical frameworks to bear on problems, but also undertaking evaluative and empirical work on whether interventions are working.

“The public sector management system needs to generate the best range of alternative actions for Ministers to choose from to achieve their desired outcomes. Choices include direct purchase of outputs vs. regulations, public sector production of outputs vs. private provision, and so on. Feedback on decisions needs to be built into subsequent decisions.”

This makes it clear that we are still very much in a work in progress situation with no clear understanding of how to work around – or move away from – the continuing strong commitment to separation. I have gone into the background of New Zealand's experience with trying to maintain a this formal separation as I understand that this is a critical issue in your own reform programme. Accordingly, it seems useful to provide a reasonably detailed account of the New Zealand experience in order to highlight the difficulties which result from trying to maintain that kind of separation.

Assessment

In my view, driven by the strength of the theoretical framework which informed our public sector reform process, we have created a major problem which now stands in the way of improving the effectiveness of public sector performance, particularly in in dealing with some of the more complex social issues which we now face.

The problem is not simply one of difficulty in achieving alignment between the outputs a department produces and the outcomes which its Minister seeks; much more fundamentally, it may have substantially undermined the Government's ability to deal effectively with policy issues which cross departmental boundaries -- in the language used by the Blair Labour Government in the United Kingdom, our capacity to develop "joined up" policy may have been significantly compromised.

This concern was expressed by the Hon Simon Upton in an address to the Institute of Policy Studies 1998 forum "State Sector: Next Big Ideas". He commented on the "silo" effect of contracting for outputs observing that each department tends to take a narrow view of what it is responsible for without knowing or assessing what other departments may be doing in that area or how budget resources as a whole could be more effectively deployed across the public sector in pursuit of the relevant policy goal.

What Went Wrong – And an Alternative Approach

Where did we go wrong? Arguably, by failing to take into account the real life conditions under which the public sector actually operates. Consider what can really be seen as the two major activities of any public service. These are:

- Policy advice to Government on the options which it might adopt in order to achieve its desired outcomes and, occasionally, advice on what its desired outcomes might be (in the social services, as an example, any government will be concerned to select outcomes which are realistic in relation to available resources -- financial and human -- and should want advice on what is achievable)
- Implementation, where inevitably officials will have a significant element of discretion, if only in such matters as how they choose to deliver policy, deal with the public, prioritise work flows and so on.

Other jurisdictions have been prepared to recognise the inevitability of the official's influence on outcomes. As an example, the Canadians have worked through how to reconcile the principle of ministerial accountability to Parliament with the reality of the role which officials necessarily play. In a joint paper by the Office of the Auditor General of Canada and the Treasury Board Secretariat the authors note that "outcomes are the results of main interest, those results of significance and value to Canadians. Business planning and management in government will need to reflect a results-oriented environment in order to focus the attention on outcomes (Office of the Auditor General of Canada and the Treasury Board Secretariat, 1998)

"In practice, the degree of administrative control and scope for influence a federal manager has will vary considerably in different situations. In some cases, the federal programme manager in question is the main player and has a quite significant degree of control over the results being sought. In other cases, the manager might be only one of several players trying, with the resources and authorities available, to influence the achievement of the intended results."

"Further, there are a number of key "outcomes" associated with most programmes over which public servants do indeed have considerable influence, in particular ensuring that goods and services are provided with due process, equity and fairness to Canadians."

This approach allows a practical unbundling of responsibility for outcomes. Ministers remain accountable to Parliament for outcomes within their portfolios. This is the cornerstone of parliamentary accountability. Its parallel in non-parliamentary societies will be accountability to the head of state or equivalent on the part of those persons who have immediate delegated authority equivalent to that held by Ministers in a parliamentary system.

Officials, for their part, are accountable to their Ministers for the quality of their policy advice. Was it well-grounded in analysis, both theoretical and empirical, have relevant options being considered, did officials take account of what would be required to implement the policy and were they satisfied that the necessary resources would be available within budgetary constraints? Officials are also answerable to the Parliament, not for government policy as such which is the Minister's responsibility, but for the advice which they provided the Minister.

Finally, officials are quite properly accountable to the Minister for the way in which they implement policy. Did they do so in a manner which took proper account of the Government's intended outcomes and, to the best of their ability, sought to achieve those?

New Zealand is still working through these questions, seeking to find a way of reconciling the theoretically driven separation of output and outcome responsibility with the practical realities of the world in which policy is made and implemented. One of our difficulties, interestingly, may be the very success which we have had in the improving the quality of information available for public sector financial management. This has created a preoccupation with the ability to measure accurately what it is that the public sector has done. Outputs are comparatively easy to measure. By comparison, outcomes are extraordinarily difficult to measure. Quite often they will be high level expressions of desirable states of being. Determining whether and to what extent the outcome has been achieved, let alone determining what the critical causal factors were, may prove well-nigh impossible.

Arguably, if we are to incorporate a measure of outcome responsibility for officials, then we will need to take a somewhat more pragmatic approach. Again, the Canadians point the way in the following extract from the joint paper already cited:

“Accountability for results asks if you have done everything possible with your authorities and resources towards affecting the achievement of intended results and if you have learned from past experience what works and doesn’t work. Accounting for results of this kind means demonstrating that you have made a difference, that through your actions and efforts you have contributed to the results achieved. It means you are accountable for what you can influence as well as what you can directly control. And the greater management flexibility which has often accompanied a greater focus on results provides the needed means to better manage your ability to influence outcomes. Demonstrating the results you have achieved, including what you have influenced, provides the evidence of effective stewardship of the greater flexibilities made available.”

Logically, what might be required to implement such an approach? The answer could lie in building on the "intervention logic" which officials are already expected to apply in justifying departmental bids for output funding. The essence of intervention logic lies in its requirement that officials should explain why the specific interventions for which they seek funding -- or which they are recommending their Minister to adopt -- will contribute to achieving the Minister's outcomes. Empirical evidence is expected to be part of this including evidence on whether existing interventions are working.

This approach already comes quite close to recognizing the nature of the contribution which officials do make to outcomes. If officials can argue cogently that a proposed intervention could be expected to make a contribution to a government outcome, then it should be possible for them to state what changed state they expect will result and how that might be recognised. It should also be possible for officials to provide some sense of timing. If this can be done, then the key components of at least an element of the type of outcome responsibility officials should properly have will be present.

Other jurisdictions, in observing our experience, have an opportunity to understand how important it is to recognise the degree to which officials actually influence outcomes and ensure that is taken to account. Failure to do so is a recipe for ensuring that government is at risk of falling well short in achieving its desired outcomes. In the words quoted above the risk is that "the regime may be reasonably efficient in producing outputs, but the outputs may be the wrong ones".

7. CONCLUSION

New Zealand's public sector reforms have sometimes been promoted internationally as though they were the "one right way". This presentation has taken a somewhat different view. Some elements of the reform process have proven extremely successful. Others have brought with them unanticipated consequences with quite serious implications.

New Zealand led the way in the adoption of accrual accounting for the public sector. That has been an outstanding success, as have other aspects of public sector financial management, including one which has not been covered in this presentation, the Fiscal Responsibility Act which underpins central government fiscal discipline by imposing a high measure of transparency and setting statutory standards for responsible fiscal management.

The New Zealand approach to the management of state-owned enterprises also has much to commend it with its emphasis on economic value added monitoring of performance and an objective, arms-length, process for appointing directors. It is probably as good a model as has been developed anywhere, but like all models for public ownership, it is ultimately dependent on continuing political will. Experience with using companies in situations where the government has a policy interest over and beyond efficient management, and/or markets may not be contestable, is less compelling but the lessons for others nonetheless extremely worthwhile. In essence, the culture of organisational structure matters.

The reforms of the core public sector have had both good and less good outcomes. There is no doubt but that they have resulted in a significant improvement in efficiency. Of concern, though, is the impact the reforms may have had in areas such as capability, the collective interest of government, public sector ethos and the linkage between outputs and outcomes. The use of a theoretical model based on distrust has also brought difficulties with it – as one commentator has observed this can be a self-fulfilling prophecy; mistrust begets mistrust.

There is evidence that the theoretically attractive separation of responsibility under which officials are accountable for outputs and ministers for outcomes has had a number of adverse impacts including a void in parliamentary accountability and a lesser focus on cross-departmental coordination.

As much because of the "unfinished business" resulting from the unanticipated consequences of some of our reforms, as because of the undoubted success we have had in areas such as the adoption of accrual accounting, the New Zealand experience provides a very valuable laboratory for public sector reform in other jurisdictions. My final comment is that drawing on this experience should be seen as an integral part of other reform programmes, not necessarily to replicate what we have done, but to avoid the potentially heavy costs of failing to learn from our experience of what does not work, or may cause unexpected difficulty.

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