

PUBLIC MANAGEMENT IN NEW ZEALAND

LESSONS AND CHALLENGES

GRAHAM SCOTT

NEW ZEALAND BUSINESS ROUNDTABLE

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Dedication
To my father Alex Scott

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LIST OF ABBREVIATIONS

ACC	Accident Compensation Corporation
APEC	Asia Pacific Economic Co-operation
CCMAU	Crown Company Monitoring and Advisory Unit
CHE	Crown Health Enterprise
CPI	Consumers Price Index
DPMC	Department of Prime Minister and Cabinet
FMR	Financial Management Reform
GAAP	Generally Accepted Accounting Principles
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GPRA	[US] Government Performance and Results Act 1993
HFA	Health Funding Authority
HR	Human Resources
HSC	Higher Salaries Commission
IRD	Inland Revenue Department
IT	Information Technology
KRAs	Key Result Areas
MMP	Mixed Member Proportional electoral system
MP	Member of Parliament
NGO	Non-governmental Organisation
OECD	Organisation for Economic Cooperation and Development
PSA	Public Service Association
RHA	Regional Health Authority
SES	Senior Executive Service
SOE	State-owned Enterprise
SRAs	Strategic Result Areas
SSC	State Services Commission
TDB	New Zealand Tourism Board
TQM	Total Quality Management
WINZ	Department of Work and Income New Zealand
WTO	World Trade Organisation

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Graham Scott

FOREWORD

No one is better positioned to tell the story of New Zealand's transformation from a command and control administrative system to a performance-driven public sector than Graham Scott, the intellectual architect of the reforms and the official who, as Secretary to the Treasury, had the lead role in translating the blueprint into concrete practices. What is truly remarkable about this book is the objectivity and thoughtfulness with which Scott assesses the New Zealand model. This is not an apologia for the path taken by his country, nor even an argument that others should follow in its footsteps. But it does offer a rich menu of ideas and experiences for any country determined to improve public management.

There is much to be gleaned from this book – the core ideas, anchored in institutional economics, which gave coherence and direction to the reforms; the centre-left political leadership that cast much doctrine overboard in recognition of the need to break with embedded practices and ideology; the skilled and motivated public officials who energised the reform effort and devised innovative ways for conducting public business. There are also lessons to be learned from the shortcomings and disappointments experienced by the New Zealand reformers.

In contrast to some other countries that have embraced the new public management, the New Zealand model is not a shopping list of reforms from which government can choose the ones it likes. Rather, it is a coherent, disciplined strategy for dismantling the control structures and compliance mentality that stand in the way of effective management, and for building in their place novel arrangements based on the freedom of managers to exercise professional judgement in carrying out assigned responsibilities.

The New Zealand administrative pioneers understood that managerial freedom must be as absolute as can be prudently provided in order for government to demand accountability for results. New Zealand has taught us that it is not enough to deregulate one control or another, because as long as managers are bound to procedural rules and input controls, they will operate within a culture of compliance. They will judge their own performance, and be judged by others, in terms of their fidelity to prescribed procedures.

But as a quid pro quo for freedom, New Zealand demands accountability for both use of resources and programme results. There is much evidence in the New Zealand model that the government takes accountability seriously. From the *ex ante* specification of outputs through the audit of both financial and substantive results, the model insists that those who run operations be accountable for what they have done. The accountability framework is backed up by multiple reporting and monitoring requirements. Despite all this, however, Scott shows serious gaps in accountability. One generic problem, which other countries moving to new public management have grappled with, occurs at the intersection of ministerial and managerial levels. Exactly where does the responsibility of politicians end and that of public servants begin? Are ministers and managers accountable only for matters in which they are directly involved, or should they also have vicarious responsibility for shortfalls in performance by subordinates? And, if the answer to this question is “yes”, how many echelons down the administrative hierarchy should they be accountable for?

These questions were forced to the fore in the Cave Creek tragedy that is discussed in this book. This writer, however, has a somewhat different view of the issue than Graham Scott has. In my view, the State Sector Act 1988 was purposely succinct in the responsibilities it enumerated for departmental chief executives. A long list of responsibilities would have conveyed the notion that only matters mentioned specifically in the Act were in the province of the chief executive. A short list gave a different message: the chief executive is accountable for all managerial actions (and, in the case of Cave Creek, inactions) in the department.

This book raises another issue that goes beyond accountability to the emerging structure of contemporary government. New Zealand has a large number of Crown entities, independent agencies that carry out public functions. Because they are outside the departmental structure, Crown entities are not subject to various accountability arrangements, but because they use public money and are entrusted with public responsibilities, they cannot be fully autonomous. In dealing with this problem, Scott reports, the government has improvised new contractual and reporting mechanisms for Crown entities.

This issue is of considerable interest for governments modelling their public administration along the lines of New Zealand's. Quite a few countries, especially in the developing world, have created autonomous agencies to free them from many of the administrative restraints imposed on line

departments. Although establishment of agencies is often justified as a means of orienting public management to performance, in many cases the true motive is to exempt these entities from government-wide limits on employee salaries. In considering the agency model, countries should be aware of both sides of the managerial ledger in New Zealand. Managers have been freed up to manage, in exchange for which they have been subjected to a stronger regimen of accountability.

Separation of agencies from departments or ministries is not the only New Zealand innovation that has been replicated elsewhere. Practices that were untried and *avant garde* barely a dozen years ago are now being mainstreamed in a growing number of countries. These include maintaining accounts on an accrual basis, audited financial statements, targeting outputs in advance of the fiscal year, reporting on contingent liabilities and transparency in fiscal policy. But not all New Zealand innovations have found application elsewhere. Few countries have shifted their budgets to an accrual basis, hardly any impose a capital charge; none has been so dogged in purging input controls and in giving managers free rein in deciding the mix of operating expenditures. None allocates resources by output class, and none has such an extensive network of contracts as is used in New Zealand. In effect, quite a few countries have done what New Zealand eschewed: they selected portions of the reform agenda. This may be a sensible approach because various studies have shown that much of the gain in managerial performance comes from removing deadweight controls.

No country has been as bold as New Zealand in managing by contract. Contracts cover both individual and organisational performance, the former through performance and employment agreements, the latter through purchase agreements between the minister who purchases output on behalf of government, and the department that supplies the output. As with commercial contracts, the purchase agreement specifies the resources to be provided and the goods and services to be produced. As Scott explains, similar contracts have been introduced to formalise the relationship between government and Crown entities.

But formal contracts are not necessarily enforceable contracts, and the internal markets (within government) in which these contracts are supposed to operate are not the same as real markets. Moreover, New Zealand experience has shown that just because ministers have the option of purchasing services from outside sources does not mean that they actually behave in this manner. Most public outputs are produced by public

employees working in New Zealand government departments or Crown entities.

Is the contractual model, then, excess baggage that can be thrown overboard without risking a loss in performance? A sensitive reading of what New Zealand has accomplished suggests that the informal side of the reforms deserves recognition. The performance and purchase agreements establish relationships between the government and chief executives, and between ministers and departments that soften the hard edge of contractualism and promote dialogue and understanding and lead, in my view, to enhanced performance, lower transaction costs and less conflict. The New Zealand model works, though not always in ways anticipated by its architects.

More than a dozen years after it was launched, reform of the public sector in New Zealand is still a work in progress. Some of the most prominent features of current public management – purchase agreements, strategic result areas (SRAs) and key result areas (KRAs), and fiscal transparency – were added years after the first reforms were introduced. The various add-ons have been consistent with the original framework; they have filled some of the gaps and responded to issues not foreseen at the outset. Scott's book hints at further reforms in the years ahead, dealing with outcomes, use of evaluation, strengthening the government's ownership interest, clarifying the status of Crown entities and more.

The fact that there never is a final chapter in managerial reform enhances the contribution that Graham Scott has made to the literature of public management reform. His book should be read, not only for an understanding of how the New Zealand model unfolded, but also for an appreciation of the reform agenda that lies ahead. His is an historical work that tells us a great deal about the next generation of managerial innovation.

Allen Schick

P R E F A C E

This book is about public management in New Zealand, which refers to the executive functions of government. An authoritative statement on the realm of public management is that:

... public managers collectively perform a significant part of the executive functions of government. Public managers are the human capital of the government's executive capacity. The contributions of these actors are shaped and constrained by diverse authorities: constitutions, statutes, administrative arrangements and practices, court orders, and political custom.¹

The aspects of public management that are the centre of attention in this book are the public managers and the frameworks of law, administration and convention that surround them. Public managers include ministers, board members and executives who direct the organisations that design and implement government policy. The surrounding frameworks put the managers in their positions, set their objectives, and create conditions for motivating, evaluating and removing them. The past 13 years have seen great changes in public management. The State Sector Act 1988 was designed in the months following the 1987 election and this Act, in concert with the Public Finance Act that followed in 1989, launched a revolution in management within the core public sector. It also foreshadowed a revolution in the management of Crown entities. These semi-independent public organisations now account for a large sector of government administration. The management system surrounding Crown entities has been incomplete in some respects and is overdue for attention, as I argued four years ago.²

New Zealand's public management reforms set a new deal between chief executives of departments and boards of Crown entities on the one hand and ministers on the other. A unique framework was created for the employment

¹ Laurence E Lynn, *Public Management as Art, Science and Profession*, Chatham House Publishers, New Jersey, 1996, p 2.

² Graham Scott, "Continuity and Change in Public Management: Second Generation Issues in Roles, Responsibilities and Relationships", speech to Future Issues in Public Sector Management Conference, Plaza International Hotel, Wellington 26 March, 1997.

and motivation of boards and top managers in the public sector. The departmental chief executives were given greater freedom to manage their organisations than in any other developed country, even to this day, although the gap is closing. This was intended to liberate chief executives in order to introduce management systems and philosophies that promoted the efficiency and effectiveness of their organisations. This freedom to manage was to be matched by the accountability of boards and chief executives for demonstrated performance.

This book tracks the evolution of public sector management and considers lessons learned, the current state of the system and areas for improvement. It discusses the framework surrounding top management in the core activities of government centred in the departments and ministries. This framework consists of the constitutional and operational relationships of the managers with politicians, processes for recruitment and appointment, decision-making rights, performance specifications and assessments, remuneration, incentives and accountability requirements. The discussion also considers the processes of and behaviours by managers and politicians within the frameworks.

The omission of a chapter on state-owned enterprises may seem surprising. There is not much to say, however, in evaluating the early state-owned enterprises, that has not been well said by others. Furthermore, most of these enterprises have now been privatised. The study by Ian Duncan and Alan Bollard³ covers the ground well. Suffice it to say that the state-owned enterprises policy has been very successful in terms of the objectives that were set for it and the policy has continued to serve us well where the conditions for its success, that were spelled out 15 years ago, apply. State-owned enterprises policy has not done well where it was applied subsequently in areas such as health, electricity and broadcasting where those conditions do not all apply. One lesson we have learned is that when state-owned enterprises are expected to achieve non-commercial objectives, all the complexities caused by multiple accountabilities, that are familiar around Crown entities begin to arrive on the scene. The muddle in television broadcasting illustrates the point. In this case there are strong political directives and pressures on the board, which has intervened deeply into the conventional responsibilities of management. The study of these enterprises

³ Ian Duncan and Alan Bollard, *Corporatisation and Privatisation – Lessons from New Zealand*, Oxford University Press, Auckland, 1992.

and those in permanent government ownership, rather than in passage to the private sector, is too large to include here. However, a thorough study of them is overdue.

This book does not attempt to examine the performance of individual government departments. Rather, it takes a government-wide perspective, particularly with regard to the topics of strategy and co-ordination across the government agencies. It does not duplicate the methodologies used by the two reviewers, Basil Logan and Allen Schick, who were commissioned by the government.⁴ I do, however, comment on both those studies. In addition to the research I have done for this book, my views are based in part on the experience of 23 years' employment in various positions around the government.

I have written this book out of a conviction that New Zealand can realistically aspire to have one of the very best managed governments in the world and also out of my interest in how we are doing in that regard. In the early years after the reforms I was impressed by the innovation that was beginning to show through in many places. Some of it was clumsy, but there was a desire to get on with things and to learn new approaches. The critical foundations for better decisions about the allocation and management of public resources had been laid. So much rotten management was cleaned out early in the reforms that it seemed to me that the trend towards improvement would continue and intensify. There were, however, weaknesses in the commitment to and incentives for seeking incremental improvements in reforming government agencies. Also, there were weaknesses in implementation in some areas and, as with all management change, some unintended side effects.

I left the Treasury in 1993 and, after a few years of working in other countries, I undertook some assignments for the New Zealand Government. I was also appointed as the chair of the Central Regional Health Authority, then later the Transitional Health Authority and the Health Funding Authority. As an insider again, I saw weaknesses in some vital management processes, in the capability for policy making and in the ability to implement new policies.

⁴ Basil Logan, *Review of State Sector Reforms*, Steering Group Review of State Sector Reforms, November 1991. Allen Schick, "The Spirit of Reform: Managing the New Zealand State Sector in a Time of Change", a report prepared for the State Services Commission and the Treasury, 1996. These two reviews involved field work with access sanctioned by the government to people and information.

Some of the weaknesses existed in the government-wide management systems and some within particular organisations. While the best management was as good as I had seen anywhere in the world, there were trouble spots. I worked with two departments that had the superficial appearance of best-practice management systems, while below the surface nothing much had changed. Departmental reviews showed that some of the government departments that had been poorly managed before the reforms were still badly managed, years later.

The challenges of creating high-performing Crown entities seemed to have been addressed only partially. These entities had been orphaned in the reforms at the beginning and left for later attention. Successive attempts to develop a clear framework for them in amendments to the Public Finance Act 1989 had not been followed up by the complementary developments needed for a comprehensive improvement in performance. I experienced the practical consequences of this lack of framework in chairing the boards of three health purchasing authorities. Initially, the roles of the agencies involved were ill-defined and the accountability and funding systems lacked necessary sophistication. The authorities had complex multiple objectives and were forever balancing the requirements for public accountability and independence of action against the requirement to be responsive to parliament, to ministers and to their official advisers. The management systems were unstable and inefficient.

I noticed also that there seemed to be more energy exerted in the quest for better management in government in several other countries I was working in than I found at home. New Zealanders have high expectations of what their government will do for them and place demands on major public institutions that can only be met by the most skilful and inspired management. Our willingness to innovate quite boldly is well established and the best public management in New Zealand is demonstrably as good as it gets anywhere in the world. There are, however, numerous innovations that have begun with great promise, but that have not been followed through and some lie neglected. We have talked incessantly about some problems but have left them unsolved, such as the identification and development of top managers.

This book is critical of some people and some situations that have arisen within the public management reforms in New Zealand. My purpose in such references is solely to extract the lessons I think we should learn in seeking improvements in management in the future. I acknowledge the splendid

achievements of managers and their ministers in some areas of the government, but I have become increasingly concerned at the evidence of ordinariness in management and outright failure in a few places. It seems to me that there has been a drift back into the old habits of ill-founded central control and to a tolerance of managers in some places who lack the skills and the motivation to take their organisations to world class benchmarks for performance. While some stunningly good managers are in evidence, we are, across the whole of government, performing below the ambitious goals to which we should aspire.

At the core of this book is an assertion that public management has an influence on the life of a country that is significantly independent of political ideology and, to a lesser extent, the policies that governments set in place. While it may seem implausible to career public managers, there are a significant number of academics who are not persuaded that management alone has more than a marginal influence on public policy outcomes. These academics claim that what matters is the policy rather than the management and point to the lack of systematic evidence that executives, and the functions they perform, make a difference to the success of public policy. Lynn raises this question:

... do public managers leave only faint footprints – do they at best only mediate the influence of larger political, structural, economic, or social forces? That the field's answer favors significant influence is primarily an article of faith based on practice, wisdom and casual observation, not an empirically demonstrated truth.⁵

It can be difficult in particular circumstances to judge the performance of senior public managers in isolation from the quality of the policy they are required to administer. Policy and management are not entirely separate realms. It is impossible for a department to manage its way around a really badly designed policy, just as one cannot demonstrate one's driving skills stuck in a traffic jam. Bad policy can look like bad management. On the other hand, one of the hallmarks of excellent public management is that it produces a beneficial influence on the evolution of the policy in question over time. Conversely, bad management can undermine a good policy. These interactions complicate the assessment of the independent influence of management.

⁵ Lynn, *op cit*, p 5.

New Zealand's reformers thought that superior management makes a real difference that is large and worth striving for.

I am not interested in tidy management of government for its own sake, nor am I impractical about the compromises with best practice management that even well-managed governments, in reality, make daily. Government is a messy business at times because it is a reflection of the political forces driving it along. My concern is not for the little details but for the quality of management overall, although managers must be riveted by those details that matter, as Aucklanders discovered when the lights went out following the explosion of underground power cables.

Aside from the policy principles that should guide decisions about when a government should intervene, a society should not allocate a major role to its government, in the way that New Zealanders traditionally have, unless that government has strong management capability. Ultimately, governments can only have the policies that they can manage and a badly managed government is best kept small. The more complicated the policy, the greater the demand for skilful management. We need comprehensive excellence in the practice of management by government to help meet current and future challenges. This book acknowledges past successes in enhancing the management capability of government, but it also endeavours to point out the weaknesses and what should be done about overcoming them.

LAUNCHING THE REVOLUTION TO THE STATE SECTOR IN 1987

In October 1987, a group of four concerned ministers and some of their senior officials held several long meetings at the State Services Commission (SSC) to discuss the personnel and industrial relations arrangements for the New Zealand public service. They sought ways to improve the effectiveness of government departments by initiating changes in the management framework as a whole for the public sector. Over the next 18 months, a radical new public sector management framework was put in place based on the State Sector Act 1988, the Public Finance Act 1989 and related legislation.

These public sector reforms included giving unprecedented degrees of managerial freedom to departmental managers, and the boards and management of autonomous agencies that later became known as Crown entities. At the same time, the government was withdrawing from a range of commercial activities through a programme of creating state-owned enterprises (SOEs) and by privatising many enterprises.

The ministers, Rt Hon Geoffrey Palmer, Hon Stan Rodger, Hon Roger Douglas and Hon Richard Prebble, had already been closely involved in the government's programme of privatisation, the establishment of SOEs and the major restructuring of government departments. The time had come to consider what improvements could be made to the departments with functions that were not going to be corporatised or privatised and that would remain in the core public service.

These ministers believed that some of the basic principles that underpinned the SOE policy could usefully be applied to the departments as well. In particular the ministers wanted emphasis on clear managerial authority, clear organisational objectives and effective systems of accountability.

One member of the group, Geoffrey Palmer, who was deputy prime minister at the time, was motivated by what he saw as the cumbersome and rigid nature of the existing public service bureaucracy and the government's inability to control how much money was spent and what it was spent on.

The State Sector Act was a reform which came from the same stable as the State Owned Enterprises Act 1986. It was based on much the same concept about public administration, namely the relative lack of responsiveness of large bureaucracies. It acknowledged the very considerable difficulties in ensuring that

those bureaucracies used resources in a way that was efficient, responsive and flexible, and also the need to reduce the rigidities in the public sector so that there could be greater responsiveness and greater flexibility.⁶

A group of young, vigorous, and able Ministers saw for themselves what it was like. They acted accordingly.⁷

The economic and fiscal background at the time helped evoke these strong responses. The fiscal crisis in 1984 caused the government to embark on major tax reform and to launch an energetic search for reductions in public spending. An attempt by a group of senior ministers in 1985/86 to scrutinise all government departments highlighted the poor information base for decision making and the perverse performance incentives for managers. They were dismayed, for example, that heads of departments were paid partly in relation to the number of staff they employed. A few departmental heads spoke to the ministers of the distortions created by the management system:

- The information system was based on inputs and largely useless for making effective decisions.
- The incentives affecting ministerial and departmental decision makers were not aligned with the government's need for a comprehensive grip on public expenditure.
- The system created incentives for managers to protect and expand their resource bases and the information available made effective external scrutiny of resource use and risks very difficult. For example, the accounting conventions used for the electricity department, and prescribed by law, concealed the true financial situation in that huge sector of government activity.
- Ministers saw the budget process as a game in which the winner extracted the biggest expenditure increases from the minister of finance.
- The input controls led to complaints from managers to their ministers that they could not use their discretion to raise efficiency and effectiveness in ways that could be demonstrated as practical common sense.

⁶ Rt Hon Geoffrey Palmer, "Political Perspectives" in John Martin and Jim Harper (eds), *Devolution and Accountability: Studies in Public Administration* No 34, Wellington, Government Printing Office, 1988, pp 1–7.

⁷ Rt Hon Sir Geoffrey Palmer, Memorandum to Graham Scott dated 21 July, 1994, Wellington.

Previous attempts by government at expenditure control had attempted to impose 'tit-for-tat' rules that required new departmental expenditures to be financed out of savings. There had also been attempts to impose uniform cuts across all departmental expenditures that did not stick and that produced total savings well below the targets. These experiences led the Treasury to seek more penetrating and rational expenditure policies. This, in turn, would require new approaches to management systems.

Besides the need for better management of public expenditure, the feeling among ministers was that many government departments were hide-bound, inflexible and insufficiently concerned with the quality of services to the public.

THE VIEWS OF THE MINISTER OF STATE SERVICES

The Hon Stan Rodger, minister of state services and a life member and former president of the Public Service Association, was strongly committed to retaining the traditionally apolitical nature of the public service, but he too believed that fundamental reform was essential. He was troubled by several matters, including:

- the ability of permanent departmental heads to blame poor departmental performance on the activities and detailed input control policies of the Treasury and the SSC;
- a 'sameness' or 'greyness' about the kind of people being appointed to senior public service positions and the under-representation of women, Maori and other groups;
- a feeling on the part of many of his fellow ministers that they lacked any effective input into the appointment process for permanent departmental heads;
- the restrictions on the appointment to key positions of suitable people from outside the public service needed to be removed;
- the negative and stifling effects of the provisions in the public service for appeal by insiders against the appointment of outsiders;
- the lack of progress on the application to the state sector of the new employment arrangements that the government had introduced to the private sector; and
- the 26 percent increase in the first general pay settlement for state employees made by the new Labour administration, amounting to an extra two billion dollars.

In his speech introducing the State Sector Bill, the minister said what was needed was:

... a set of personnel and industrial arrangements that encourage rather than inhibit good performance by departments and individuals.

ADVICE BY OFFICIALS

The Treasury officials advising the ministers stressed the important contribution that direct accountability between chief executives and their ministers could make to a new and effective public service management system. In doing so, they were continuing to promote the ideas first set out in 1984 in *Economic Management*, the Treasury brief to the incoming Labour government, subsequently published as a book. The concepts there were expanded and developed in a further published briefing to the government after the 1987 election that was titled *Government Management*.

In that brief, the Treasury argued that a well-managed government should have six characteristics:

- clear objectives that inform managers what is expected of them and enable their performance to be monitored;
- transparency in setting out those performance objectives and the means by which they are to be pursued;
- a structure that minimises the potential for 'capture' of policy by the people and organisations who are providing services;
- incentives for managers and staff to achieve the goals of the government rather than their own goals;
- effective use of relevant information to promote effective performance; and
- contestability of both policy advice and service delivery.

In essence, managers should be given greater discretion and authority, matched with effective accountability for clearly specified results, and much greater use should be made of formal arrangements to clarify roles and performance requirements.

Specific changes recommended by the Treasury included:

- the establishment of a clear, unbroken line of accountability from ministers to their departmental heads and from departmental heads to the staff in their departments;
- greater involvement by cabinet in appointment and other employment decisions about the heads of departments, and by heads of departments in employment decisions about their staff;

- the dismantling of external controls over inputs; and
- the introduction of a robust performance management system based on specified performance requirements that would feed into the performance assessment and career development for staff and into employment decisions about the departmental heads.

The Treasury also advocated new approaches to the structure of government and to budgeting, accounting and financial management. These were subsequently adopted by the government and led to some profound changes in the way in which the public service was organised and did its business.

Officials from the SSC who were advising the ministerial committee supported the directions of the reforms and, in particular, promoted the alignment of public sector labour law with the private sector labour law that was being revised at that time. The procedures for negotiating wages and the resolution of disputes were the focus of attention. The officials also stressed the need in any new arrangements to retain the key values of the old system, such as its non-political character and its essential ethics and values. The officials favoured the retention of at least some measure of effective central control in order to promote these values and characteristics; consequently the SSC promoted the concept of the senior executive service.

TIMING OF THE INITIATIVE

The October meeting of the ministers at the SSC took place in the weeks following the election in 1987 at which the Labour party increased its already large majority in parliament. The government, or at least these ministers, felt it had a mandate to continue its aggressive programme of economic and state sector reform.

Timing was also influenced by the frustration within the government at its inability in the previous term to negotiate changes to state sector management systems with the unions.

In 1986, Hon Stan Rodger released a document known as the 'buff paper'. It advocated a number of major changes to the existing pay-fixing arrangements within the state services. These included removal of the provision for general pay adjustments for all state employees, greater recognition of individual performance, reference to market conditions in setting pay rates, removal of automatic annual pay increments, and the application of private sector employment arrangements to state employees. However, the state unions rejected these proposals. Apparently, they believed that their influence within the Labour party was sufficient to forestall any changes they considered adverse to their interests.

In 1987, a reform of private sector employment and industrial bargaining arrangements was enacted in the form of the Labour Relations Act 1987. The Act's thrust was to move private sector industrial relations away from processes that involved third parties in disputes and to place emphasis on bilateral negotiations between the parties.

In the end, the State Sector Act of 1988 introduced an even more radical set of reforms that lined up the state labour laws with the private sector and gave the heads of government departments and other entities the same powers as private sector employers.

HISTORICAL BACKGROUND

The zest for reform in 1987 arose out of frustration at a set of management and employment arrangements in the public service that had remained largely unchanged since a royal commission in 1962 and a management philosophy that dated back to reforms from an earlier commission in 1912.

Those existing arrangements were seen as a key part of a public service management system characterised by poor performance specification, few incentives to perform well and to promote the interests of the government of the day, and an inadequate level of efficiency. These arrangements had emerged over a long period and had their roots in earlier reforms designed to address other issues in other times.

Early reforms

The reforms in 1912 addressed problems of low morale, politicisation of policy and personnel and lack of professionalism and stability. There was also a link back to the much earlier Trevelyan reforms of 1854 in the United Kingdom, which were the foundations of an independent, but elite, civil service. Similar reforms in the early twentieth century occurred in the United States, Canada and Australia.

The 1912 reforms were based on the work of a royal commission⁸ although not all of the commission's recommendations were adopted. As far as the commissioners were concerned, the primary objective of reform was to increase efficiency. They felt that the best source of ideas on how to enhance efficiency was to be found in best practice in the private sector. Even the practice of always promoting staff from within the public service, a

⁸ W Hunt, *Report of the Commission to Inquire and Report Upon the Unclassified Departments of the Public Service of New Zealand*, Appendices to the Journals of the House of Representatives 1912, H 34.

practice that was later criticised as being inefficient and inappropriately protectionist, was advocated as best contemporary business practice.

The commissioners also had strong views on the merits of an external appeal system of the kind that was introduced in the subsequent legislation. Their view was that “an outside Appeal Board that can override the management is a decided mistake”.⁹ In this respect, the commissioners were ahead of their time.

The key features of the personnel management system that was introduced in 1912 were:

- employment of all public servants under the direct authority of a single central personnel authority known as the Public Service Commission;
- entry usually direct from school;
- a period of probationary employment before entry into the ranks of permanent staff;
- security of tenure (subject to good behaviour);
- individual staffing decisions on issues such as appointment, promotion and grading made independently of ministers;
- annual salary increments to specified maximum levels;
- internal promotion in accordance with a definition of merit laid down in statute;
- a system of grading positions on a long salary scale depending on each job’s assessed content and responsibility;
- external rights of appeal against personnel decisions to three-person boards that typically included a person with a public service management background, a person with a public service union background and an ‘independent’ chair; and
- pensions on retirement.

Later reforms

These features were modified during the 1960s and 1970s through:

- classification of the public service into a large number of cross-departmental occupational classes for the purposes of determining pay and gradings;

⁹ Hunt, *ibid*, p 17.

- introduction of arrangements for regular general pay movements for public servants based on private sector pay movements;
- establishment of the State Services Commission to replace the Public Service Commission; and
- progressively greater delegation of routine personnel decisions to individual departments.

The 1962 McCarthy Royal Commission advocated the establishment of a single state services commissioner with personality and ability who would be 'forcefully willing' to use his (*sic*) powers to promote high levels of efficiency and economy. This recommendation was not accepted by the government of the day that instead established the SSC as a multi-member commission.

Employment arrangements

During the period from 1962 to 1988 the public service retained a set of employment arrangements distinctively different from those in the private sector.

Departments did not have the authority to enhance the conditions of employment determined by the SSC. All personnel decisions were still taken under authority delegated explicitly from the SSC, and not a great deal of authority was delegated. A permanent head of a large government department could not dismiss a permanent member of staff for proper and sufficient cause, even subject to later external review. Rather, a recommendation had to be made to the SSC that formal charges be laid against the officer concerned. The Public Service Appeal Board then heard the charges and made a binding decision, including any penalty to be paid.

Government departments were run by permanent heads who, as the name implies, were appointed on a permanent basis typically until compulsory retirement at age 60 to 65, depending on when the person concerned had first joined the public service. It was common for people to be appointed as permanent heads within a few years of compulsory retirement. Because of this, and because there was limited mobility between permanent head positions, the turnover of permanent heads was greater in practice than the term suggests.

Permanent heads, and other top public servants, were appointed under section 29 of the State Services Act 1962. This system was popularly known inside the public service as the 'College of Cardinals'. Appointments were made by a panel consisting of two members of the SSC and two permanent heads drawn from a panel elected from time to time by all existing

permanent heads. There was also a statutory preference for appointing candidates from inside the public service to any positions below permanent head. Positions below permanent head were subject to appeal to an external appeal board and the decision to appoint an outside candidate had to be justified on the grounds that the person appointed had 'clearly more merit' than the internal candidates did. This in fact usually meant the number of years worked in the public service.

The remuneration of permanent heads was determined by the independent Higher Salaries Commission (HSC), which replaced the earlier Advisory Committee on Higher Salaries. This commission was to follow a set of statutory criteria that included comparability with the private sector and the need to recruit and retain necessary skills. In practice, the HSC appeared to give significant weight to general relativities between broad classes of managers and not much regard to the specifics of recruitment to particular positions.

Permanent heads and other senior public servants were usually members of the Government Superannuation Fund, which provided them with an inflation-proofed pension based on a proportion of their average salary over their last five years of service prior to retirement. This proportion was calculated as the number of years served divided by 40 years, being the maximum term of employment one could work as a public servant. At one time, membership of the fund was compulsory. This approach to superannuation had the effect of providing a substantial cross-subsidy benefit to public servants who reached a top position late in their career, having previously bought many qualifying years for their pension at a much lower salary. The effects of inflation indexation increased this benefit.¹⁰

Permanent heads and other senior public servants were usually members of the Public Service Association (PSA), which represented public servants

¹⁰ The effective level of government contribution to the superannuation benefits of members of the Government Superannuation Fund, which also included employees of the Post Office and New Zealand Railways, was not easy to calculate because of the "benefit promise" nature of the scheme. Actuarially, the average government contribution was calculated as being the equivalent of about 11 percent of base salary. For much of the period during which the system applied, high inflation rates and high marginal tax rates (up to 66 percent) meant that the actual level of benefit was much higher than this, particularly in the late 1970s and early 1980s. A person entering the public service in the late 1970s, who wished to secure the same level of equivalent after-tax benefits from a private superannuation scheme as were then available under the government scheme, would have had to pay over 40 percent of salary to the private scheme.

individually and collectively in negotiations and in disputes with their departments, the SSC and the government on matters relating to their employment.

It was the cumulative effect that these earlier reforms had on incentives for policy innovation, efficiency and effectiveness that the 1987 reformers had in their minds. They wanted to preserve some principles of the system, for example political neutrality, but believed these earlier reforms had run their course and the system that had evolved in practice was no longer in tune with the current political and economic requirements.

THE REFORMS – CONTENTS AND AN ANALYTICAL PERSPECTIVE

INTRODUCTION

The 1987 initiative to reform the core public sector was the beginning of a sequence of steps that were intended to improve the efficiency and effectiveness of public management. This work led to a complete reframing of the law relating to public management and large changes to management processes and practices. Throughout the 1990s there were further initiatives to revise and upgrade some aspects of the first wave of reform and to add new agendas that were not initially considered. Many issues remain to be addressed satisfactorily within the overall conception of the management system. In addition, there are criticisms of the public management system that influenced the Labour/Alliance government that was elected at the end of 1999. The Labour/Alliance government had given some early indications of its thinking at the time this book was completed.

For readers who are not already familiar with the management reforms, this chapter sketches briefly the foundations of the new system that emerged over the last 14 years.

Major building blocks of the management system are:

- The State Sector Act 1988.
- The Public Finance Act 1989 and Fiscal Responsibility Act 1994.
- The system of performance management and accountability that rests on this law.
- The restructuring of organisations.
- The strategic planning system for the government.
- The codified expectations of public servants.
- The governance and management framework for Crown entities.

These points are outlined below.

THE STATE SECTOR ACT 1988

The State Sector Act 1988 struck a new framework of relationships between the parties involved in public management.

Chief executives

The Act symbolised the change in the role of departmental heads by altering their titles from permanent heads to chief executives and by making them responsible to their ministers. Their roles included:

- carrying out the functions and duties of the department, including those imposed by legislation and government policies;
- tendering of advice to their minister and other ministers;
- general conduct of the department; and
- efficient, effective and economical management of the department's activities.

The roles remained similar to the past but the Act laid down new and specific employment criteria for chief executives.

Existing permanent heads were offered continuing employment as the chief executives of their departments for at least two years. For new chief executives, a new appointment system was introduced.¹¹ They could be appointed for up to five years and could be considered for re-appointment at the end of this time. The five-year period was chosen as a reasonable time in which a chief executive could set strategic goals, transform the organisation if required and demonstrate achievements. The five-year term also symbolised and helped entrench the non-political nature of the chief executives' role by ensuring that periods of employment were not linked to the three-year electoral cycle, so that chief executives would serve successive ministers and governments from any political party.

Chief executives were to be recruited from a broad base and paid market rates for complex and demanding jobs. It was intended that chief executives would retain their jobs only for as long as they performed well. Chief executives could be dismissed for unsatisfactory performance in a way that had not applied in the past. There was also no guarantee of a renewed contract at the end of their five-year term.

The appointment process that replaced the previous system involved:

- consultation between the SSC and the minister of state services regarding upcoming vacancies and any factors that the minister felt should be taken into account when considering applicants;

¹¹ Special arrangements were introduced for the government statistician and the surveyor-general to preserve the statutory independence of these positions.

- public notification of the vacancy and convening of a panel to assess applicants;
- a recommendation from the SSC to the minister of state services who, in turn, would forward the recommendation to the governor-general for consideration (which, in practice, meant the cabinet); and
- acceptance of the recommendation, in which case the SSC would make the appointment and notify it publicly, or rejection of the recommendation, in which case the cabinet could direct an appointment. The decision would be notified in the official publication *The New Zealand Gazette*.

Subsequent events surrounding the appointment of a person to the position of secretary of defence (described in chapter nine) confirmed that there was also a third possible outcome to this appointment process. The SSC's initial recommendation could be declined, in which case the SSC could be required to go through the appointment process again.

Remuneration and other conditions of employment for chief executives were established in an individual contract between each chief executive and the SSC. Initially remuneration was set at the level for private sector salaries at equivalent positions.

Chief executives became employers, in their own right, of all staff in their department, including senior staff. Chief executives were required to act independently from ministers on personnel matters. They were given the discretion to negotiate conditions of employment subject to some restrictions.

Public sector employment arrangements were brought much closer to private sector norms. The Labour Relations Act 1987, which governed private sector labour relations, applied to the public sector, except as otherwise provided for in the State Sector Act 1988. However, some distinctive personnel arrangements were retained, as a result of influence from the select committee of parliament that considered the State Sector Bill. These included arrangements for negotiating collective employment contracts, the replacement of old rights of appeal against employment decisions by external review for some decisions, advertising of vacant positions and their appointments, and retention of a merit test for appointments. The Act required chief executives to be 'good employers' and expectations and norms evolved over time about what this meant in terms of personnel management practices and standards.

Chief executives have a responsibility to fulfil the duties imposed by law, by government policies and their agreement with their minister. They also

have a responsibility to the cabinet for the collective interests of the government and, as public servants, they are responsible to New Zealand citizens through parliament for fulfilling their statutory duties. In carrying out these and other duties, they are monitored by their minister and the SSC.

The State Services Commission

Besides its role in the appointment and remuneration of chief executives, the SSC was given responsibility under the State Sector Act 1988 for:

- reviewing the structure of departments and the allocation of functions between them;
- reviewing the efficiency, effectiveness and economy of each department, including the discharge of its functions;
- reviewing the performance of chief executives, either generally or with regard to any particular matter;
- reporting to the relevant minister on the manner and extent to which their chief executive was fulfilling all of the requirements imposed by the State Sector Act 1988;
- promoting and monitoring personnel policies, including equal employment opportunities;
- advising departments on training, career development, management systems and structures;
- negotiating collective employment contracts, with the power to delegate this if it chose;
- dealing with some grievances with individual employees;
- approving internal appointment review procedures established by departments; and
- issuing a code of conduct to be binding on staff in all departments.

A later amendment, the State Sector Amendment Act (No 2) 1989, replaced the previous commission of four with a single commissioner and a deputy commissioner. However, the SSC's functions remained essentially the same.

While the relationship between chief executives and their ministers was pivotal, the SSC held the role of 'referee' between ministers and the apolitical public service. This led to the SSC being spoken of at the time as 'the guardian of the process'.

The SSC acted as the employer of chief executives, but responded to the role of politicians in the framework of responsibilities and accountabilities surrounding a chief executive.

The SSC acted as each minister's professional, dispassionate and apolitical agent and as sponsor and guardian of the best traditions and values of the public service. Each minister also acted in accordance with cabinet collective responsibility, subject ultimately to sanctions exercised by the prime minister.

This was a complex set of relationships and successful balancing of the tensions created by the many requirements and the different roles of the parties was essential. To achieve the right balance, the roles and rules of conduct must be clear.

Appointment and removal of a commissioner

The process of appointing and removing a state services commissioner became significant for the operation of the whole public management system.

The state services commissioner is formally appointed by the governor-general in council on the recommendation of the prime minister and can only be dismissed by a resolution of the house of representatives. The commissioner, therefore, enjoys a level of protection equivalent to that of a high court judge and is effectively beyond the reach of the government of the day.

Senior executive service

The State Sector Act 1988 established the senior executive service (SES) to promote the training and development of a skilled group of senior public servants from which future chief executives could be selected. It was designed to promote a sense of cohesion among senior public servants and an appreciation of the distinctive ethics and values of the public service. It also provided flexibility so that senior staff displaced from a department could be retained in project work before being placed in another long-term position.

The Act gave the SSC responsibility for developing the SES and required chief executives to consult the SSC on SES appointments, dismissals and conditions of employment.

The SSC had the power to designate the positions or people forming part of the SES and arranged appropriate training for current and prospective members of the SES. The SSC became involved in providing training courses, although this was not entirely successful.

SES members were to be employed for terms not exceeding five years, after which a new appointment process would be required. SES members were excluded from collective union coverage.

By 1992, a committee of chief executives chaired by the state services commissioner judged the SES a failure. Reasons given for failure were the indifference of potential members, particularly within central Wellington departments, the ability to opt out of the SES and the use of the SES to control the salaries of members. However, some senior civil servants outside Wellington reported finding some value in the concept as it helped them keep in touch with their peers. In 1997 the state services commissioner reported that the SES included fewer than 80 of the 300 potential members.¹² By 2000 the SES was moribund.

A non-political public service

The State Sector Act 1988 removed ministers from involvement in the personnel decisions made by chief executives and set up the institutions and processes to regulate their involvement in the employment and monitoring of chief executives. While the Act distanced ministers from employment matters, it strengthened their powers over what government organisations produced. The aim was to strike a balance between allowing ministers to have a role in the appointment and performance management of chief executives and protecting the non-political character of the public service by retaining an independent professional role in these areas for the SSC.

An important aim of the reforms was to maintain a non-political public service in which senior public servants would be able to serve and give free and frank advice to successive governments of different political persuasions. This concept, which is a key element of the Westminster system of government, was recognised as having practical as well as constitutional value.

THE PUBLIC FINANCE ACT 1989 AND FISCAL RESPONSIBILITY ACT 1994

The second significant building block of the management system was the Public Finance Act 1989, which introduced changes to accountabilities and requirements for managing financial matters in the public sector. It provided

¹² *The Dominion*, 10 September, 1997, p 21.

a framework for the reform of the whole financial management of government by:

- developing a definition for performance;
- removing many administrative controls;
- making chief executives responsible for departmental financial management;
- establishing departmental and Crown reporting requirements; and
- redefining the appropriation process to change the emphasis from the control of inputs to the purchase of outputs.

The fundamental concept underlying the Public Finance Act 1989 was the distinction between the government's purchase interests and ownership interests within a department. The first is a concern for the quantity, quality and price, or cost, of the services produced by a department. The second concerns the human, intellectual and other assets and liabilities available to the department for the production of current and future services. It is very significant that these concepts of purchase and ownership include dimensions other than those that can be measured in financial terms. This raises issues that are addressed in chapters seven and eight.

The unit of purchase is an output, which is explained in detail in chapter seven. Outputs capture what services the government expects to have delivered by a department. Previously, the government simply decided how much money it was willing to provide for inputs, with prices controlled by central directives. By focusing on outputs, it became possible to introduce into public sector management many new management practices. It meant that performance could be expressed as a 'deliverable' for which estimates of cost and assessments in terms of quality and volume could be made. The use of outputs allowed the former detailed controls over inputs to be relaxed. Organisations were free to mix and match inputs, as managers saw fit. The concept also supported the decentralised approach to management and made it easier to express and monitor the responsibilities that were being delegated down the line.

The Public Finance Act 1989 and decisions by the minister of finance and the Treasury authorised the removal of the central administrative controls over financial management. These were replaced by a set of financial delegations that were developed for each department according to the needs of their activities. At the same time, chief executives were made responsible for departmental financial management, whereas previously the accountability for this had been blurred between the Treasury and departments.

The Act specified a new suite of financial statements to be presented to parliament, including aggregated financial statements kept on an accrual basis. This promoted the refinement of the government's objectives and principles for fiscal policy, which were ultimately captured in the Fiscal Responsibility Act 1994. This accounting system introduced the idea of the Crown's net financial position as an indicator of fiscal performance, alongside the conventional measures of fiscal performance that focus on cash flows.

Incentives for the effective management of assets and liabilities were introduced in the form of a charge for the use of capital, which was defined as the net assets in the department's statement of financial position.

The Public Finance Act 1989 also introduced a new appropriation process that allocated funds to votes on the basis of output classes. These classes were aggregations of the underlying outputs that the departments were required to deliver under their performance agreements. The output classes provided a summarised form for the output performance that was suitable for accountability of ministers to parliament.

These new systems provided the method for specifying what the government wanted of a chief executive and a basis for monitoring performance. This method of specification led to the development of purchase and performance agreements that included a specification of outputs, requirements for strengthening organisational capacity and responsibility for managing financial risk.¹³ Purchase agreements were concluded between 'vote ministers' and the chief executives who provided outputs to these ministers. For example, the Department of Labour provided outputs to the minister of accident rehabilitation and compensation insurance. These would be covered by a purchase agreement. The minister responsible for the Department of Labour, the minister of labour, concluded a performance agreement with the chief executive that covered the outputs for that minister plus a requirement to meet purchase agreements and 'ownership' requirements. Every department and ministry had a 'responsible minister' who was the minister involved in the performance agreement. Some departments and ministries, like the Department of

¹³ The way this whole system worked, from the viewpoint of the Treasury, was captured in the document *Putting It Simply: An Explanatory Guide to Financial Management Reform*, The Treasury, Government Printing Office, 1989. A more recent document explains the system as modified: *Putting it Together: An Explanatory Guide to the New Zealand Public Sector Financial Management System*, The Treasury, 1996.

Labour, also had purchase agreements with ‘vote ministers’ other than their own ‘responsible minister’.

Parliament went on to refine and enhance the financial management reforms. The Fiscal Responsibility Act 1994 was introduced as a private member’s bill by another articulate and forceful reformer, the Hon Ruth Richardson, after her departure from her position as finance minister between 1990 and 1993. The Act imposes a medium- and long-term focus on government expenditure and provides this essential context to the operation of the budget and management cycles under the Public Finance Act 1989. The positive effect on the Health Funding Authority’s (HFA) contracting for health services from providers as a result of having a three-year path for health funding as against an annual process, is an example of the benefits of the Fiscal Responsibility Act 1994.

THE PERFORMANCE MANAGEMENT AND ACCOUNTABILITY FRAMEWORK

A third important building block of the management system was the performance management and accountability framework. This drew on the legislative foundations of the State Sector Act 1988 and Public Finance Act 1989. The main features of the management environment surrounding chief executives can be seen in the table below, which also shows how each particular piece of legislation contributed towards the overall framework.

TABLE 2.1: Management framework surrounding chief executives

- | | |
|---|--|
| 1 | Employment contract for five years with a possible extension based on performance.* |
| 2 | Possibility of receiving performance bonuses for performance above expectations or of being criticised or dismissed for performance below expectations.* |
| 3 | Commitments in the performance agreement regarding strategic results, key result areas, outputs, and management or ownership issues.# + |
| 4 | Forecast financial statements and other accountability documents to be provided to parliament.# |
| 5 | Personal responsibility for departmental finance.# |
| 6 | Annual report to parliament on performance of department based on standard questionnaire by the finance and expenditure committee.# |

- 7 Audited statement of service performance.#
- 8 Freedom to manage staff without central regulations.*
- 9 A fixed budget on an accrual basis that is either net or gross, depending on the potential for earning third party revenues.#
- 10 Budget based on resources for output production.#
- 11 Monthly monitoring of financial information to the Treasury.+
- 12 Some measure of competitive pressure from alternative suppliers of outputs and comparable pricing methods that facilitate comparison.**
- 13 A charge similar to a dividend for capital invested in the department.#
- 14 Interest rewards and penalties for variations in cash balances from agreed levels.+
- 15 Freedom to manage balance sheet within the above constraints but need parliament's approval to expand the capital base.#

Key: State Sector Act 1988 *

Public Finance Act 1989 #

Government direction +

Implicit **

The accountability systems and requirements were designed to answer five basic questions:

- *What are chief executives going to achieve and what have they achieved with the resources allocated to them?*
This referred to the outputs produced by the government agencies and the government's purchase interest in those agencies.
- *What is the state of the department's human and organisational capital and will the department be better placed to meet the demands expected of it in the future than it is now?*
This referred to the government's ownership interest in its agencies.
- *What policies should the government adopt and why?*
This referred to providing sound, frank, fearless and well-presented advice about the policy direction the government should take.
- *Are the department's activities aligned effectively with the government's strategic goals and overall requirements?*
This concerned strategic alignment and the collective interests of government.

- *How well is the department doing in contributing to better outcomes from government activities?*

This referred to departments' outputs and how they were expected to contribute positively to outcomes.

Chief executives were required to enter into negotiated agreements with their ministers and the central agencies about what they were to achieve in terms of these questions, and what they would, therefore, be accountable for within a given level of resources.

RESTRUCTURING AND CHANGING THE ROLE OF GOVERNMENT

A fourth aspect of the reforms was the restructuring of government organisations. The main thrust was to reorganise the administration by separating conflicting functions, addressing the overload on top management in huge conglomerate departments, clarifying goals and the delegation of responsibility to achieve them, and increasing the transparency of information about performance and improving incentives. These reforms were, in some cases, followed by other decisions that reduced the size and scope of the core public service.

The structural reforms were based on five principles, the first of which was a separation of ownership and purchase responsibilities. 'Ownership' responsibilities referred to the interests of the government as owner in the continuing capability and development of the ministry or department, including development of its physical, human and intellectual capital. Ownership interests also extended to financial management and risk management. The purchase interests referred to the interest in the goods and services provided by the ministry or department, such as policy advice, monitoring services and so on.

A second principle was the separation of policy making from operational activities to avoid domination of policy advice by the operational needs. For example, the Ministry of Justice provides policy advice, while the Department for Courts provides courts and associated services, and the Department of Corrections provides prison and associated services. Looking back, I think that the policy ministries should have taken a more active role in assisting ministers to establish and monitor the performance requirements for the delivery departments than they have commonly done. There is no reason in my view for a lot of difference in the performance framework around departments charged with service delivery to the public from the best of the frameworks for Crown entities doing the same thing.

A third principle was the separation of funding, purchasing and provision of services. This was pursued in health where the Ministry of Health was the funder, the Health Funding Authority was the purchaser and Hospital and Health Services were the public hospital service providers. This policy was abandoned in 2000 and the purchasing and provision of services devolved to District Health Boards, while the Ministry of Health took on the roles of policy, funding, purchasing for regional and national services, regulation and monitoring.

A fourth principle was competition between service providers. This principle had many complexities to it. While it has had some success, for example in aspects of the science funding reforms, it has failed in areas where certain key conditions for success were missing. The health sector provides an example. In the early 1990s, four government purchasers with geographical monopolies were set up to purchase services from the private and public sectors, including services from 23 hospitals which also were mainly geographical monopolies. The reforms were under-funded and the parties were largely left to years of negotiating around significant issues with mismatched revenues and costs. There were few incentives for hospitals to take on the hard parts of improving their performance, particularly when the government purchasers had nowhere else to go for most services. For the hospitals that did launch out on work to lift clinical and financial performance by consolidating sites and closing obsolete hospitals or divesting services to private sector providers, many faced constraints in terms of politicians with large 'stop' signs when the political heat became unbearable. Other problems abounded such as the issue of whether the government should be competing with private enterprise, particularly when its large providers had opportunities to cross-subsidise services. There was the difficulty in creating competition where natural or political monopolies existed. The health sector is thick with monopolies – from clinician groups to hospitals to large Independent Practitioner Associations of general practitioners (GPs).

A fifth principle was the reallocation of functions for focus, synergy and transparency. Large conglomerate ministries were dissected into more manageable forms, such as the Department of Social Welfare's division into two departments and a ministry – the Department of Work and Income, Department of Child, Youth and Family and the Ministry of Social Policy.

In some cases the restructuring led to the contracting out of functions. For example, the management of the Government Superannuation Fund (for central government employees) was contracted out to a private sector insurance company. A commercial bank was contracted to provide departments

with banking services that improved on the services that the Reserve Bank of New Zealand had provided. Computing services were decentralised and some were contracted out. This was not a necessary part of the management framework built under the State Sector Act 1988 and the Public Finance Act 1989 but a result of decisions made by the chief executives. The impetus came about because of the transparency of what the government was doing and what it was paying for doing it, together with the reduction of the incentives on managers to accumulate activities and the increased requirements on them for efficiency and effectiveness. Downsizing of departments also occurred because the government reduced the funding of some administrative activities, forcing departments to make efficiency savings.

The major changes to the role of government came about, however, through the corporatisation of commercial functions under the State-Owned Enterprises Act 1986 prior to the Public Finance and State Sector acts and also from the privatisation programme. These areas are beyond the scope of this book.

SETTING STRATEGIC OBJECTIVES

A fifth element of the reforms involved the system for strategic management across the government. Beginning in 1993, the government developed a set of medium-term planning and political management tools in the form of a system of strategic result areas (SRAs) and key result areas (KRAs). The SRAs were an expression of the government's major strategic goals, whereas the KRAs were the goals that chief executives would need to achieve to contribute to the SRAs. The SRAs were designed to provide guidance to departments and ministries in proposing outputs and other interventions to contribute to the government's goals. While no longer called SRAs, the 1999 government has issued six high-level goals and the pattern of linking outputs to these goals has continued. The new government abandoned the cabinet level structures for strategic management. The use of government-set goals and their role in the public management system is discussed in chapter 11.

CODIFYING PRINCIPLES AND EXPECTATIONS OF BEHAVIOUR

A sixth building block in the reforms was the codification of principles and expectations of behaviour. Some sceptics have, from the beginning, expressed concern that the performance management system might undermine some public sector values and ethics that should be maintained

for the future. Although New Zealand has attracted attention by jailing a former auditor-general, the public service as a whole has always been remarkably free from serious misconduct and there is no evidence that the reforms have changed this.

Professor Schick, in his 1996 review of the public sector, gave attention to the possibility that the performance management systems might undermine values of service to the public although he does not assert that this has in fact happened.¹⁴

The former state services commissioner, Don Hunn, was concerned throughout his tenure from the late 1980s to 1997 with highlighting values such as economy, probity and care for the greater good of the government and the public.

A code of conduct for the public service was prepared that captured these and other requirements. This is discussed in chapter six. Also discussed in chapter six is the much more specific guidance to senior civil servants concerning expectations of them in the event of major failures in their organisations. These guidelines were developed in the wake of the fatal collapse of a viewing platform at Cave Creek erected by the Department of Conservation.

Following an inquiry into the Department of Work and Income New Zealand in 2000, the government established a 'standards board' to add extra focus and weight to the effort to ensure high standards in public organisations.

Developments in refining the government's expectations of boards of Crown entities are discussed in chapter ten.

CROWN ENTITIES

A seventh building block in the reforms was a slow tightening of requirements around a group of organisations that came to be known as 'Crown entities'. These were neither departments nor state-owned enterprises. They carried on activities as diverse as orchestral music and health purchasing. The politicians and their advisers lacked a well thought-out strategy for dealing with these organisations at the start of the reforms. Later, revisions to the Public Finance Act 1989 made partial provisions for a more rational management framework. A growing body of evidence shows

¹⁴ Allen Schick, "The Spirit of Reform: Managing the New Zealand State Sector in a Time of Change", a report prepared for the State Services Commission and the Treasury, 1996.

that this management framework is incomplete and unstable. In 1999, some isolated problems about the values of Crown entities and relationships between their boards and ministers led to some revision of the framework. Chapter ten considers Crown entities.

ANALYTICAL FRAMEWORK AND ECONOMIC PRINCIPLES UNDERLYING THE REFORMS

Discussion and debate about theoretical perspectives have accompanied the public management reforms. Theoretical frameworks were one source of advice by officials and these have since been a centre of focus for academic evaluation and criticism of the system. The influence of theory and academic literature has been a positive feature of reform that contributed some coherence both to design¹⁵ and criticism. (For a reader with an interest in the subject, Jonathan Boston and his co-authors provide a short summary of some theoretical influences on reform.¹⁶)

While the discipline of economics had an influence in the reforms of the 1980s, the analysis of government institutions is a multi-disciplinary field. Political science, accounting, corporate finance and many aspects of the management literature offer insights into how public institutions operate and why decision makers give them the forms and functions we observe. Officials, particularly in the Treasury, drew on ideas from institutional theory, financial and accounting theory and practice and the eclectic, pragmatic literatures on public and private sector management. There is a common theoretical thread running through these applied disciplines, which is the economics of institutions. A few brief comments on the analytical perspectives behind some of the official advice are relevant to the story of public sector reform.¹⁷

¹⁵ Reviewers typically quote: The New Zealand Treasury, *Briefings to the Incoming Government: "Economic Management"*, 1984; *"Government Management"*, 1987. Also commonly quoted is G Scott and P Gorringer, "Reform of the Core Public Sector: The New Zealand Experience", *Australian Journal of Public Administration*, March 1989, pp 81–92.

¹⁶ Jonathan Boston, John Martin, June Pallot, Pat Walsh, *Public Management: the New Zealand Model*, Oxford University Press, Auckland, 1996, ch 2.

¹⁷ Some of the following discussion is drawn from a paper entitled "Remodelling the State Sector: an economic perspective" that I presented to the New Zealand Legal Research Foundation conference on Shaping the Future State Sector on 21 September, 2000.

At the end of the 1970s, the secretary to the Treasury, Noel Lough, became very concerned about the performance and prospects for the New Zealand economy. He set a group of economists in the Treasury the task of searching for fresh insights into the situation. While the focus was at first largely on the problems of structural adjustment in the economy, there also emerged a growing interest in the economics of institutions. This branch of economics analyses the form, function and behaviour of private and public institutions.

At their most general level institutions are constraints that shape human interactions and may be formal, as, for example, a written constitution, or informal conventions and codes of behaviour. Within an institutional framework, organisations, which are groups of individuals joined together in pursuit of common purposes, take shape and evolve over time. Their purposes are to take the opportunities prescribed by the institutional framework and wider environment. Over time the way organisations evolve feeds back into changes in the institutional framework. Simply put, the institutions are the rules and organisations are the players. Over time the players can influence the rules.

The key analytical concept that runs through modern institutional economics is transaction costs. People and organisations will seek to minimise these costs in the same way that they seek to minimise other costs of production. By contrast, traditional microeconomic analysis assumed that transaction costs were zero. An illustration of the concept in action is to consider the decision by a firm whether to employ someone to produce something, or to purchase whatever it is in the open market. An institutional economist would examine the relative costs of the transactions involved in employing someone and supervising the work, versus the option to purchase externally. This is an analysis that can be used for examining the costs and benefits of contracting out government functions, or separating or combining functions.

Another key analytical concept is that information is costly to acquire. We make decisions in a state where we are ignorant of the facts or where the facts are distorted. To reduce the problem this causes is expensive. Traditional microeconomics on the other hand assumed that information was freely available. The fact that information is costly leads to the problem that institutional economists label 'bounded rationality'. This means that rational individuals may make decisions, which appear to them to be the best in the circumstances, when in fact a better option was available that was passed over because they lacked information. Institutional economists think about how to improve decision-making processes in the presence of costly

information, risk and uncertainty. This is a critical consideration in designing structures and functions in the public sector.

The institutions of organisations and individuals provide the energy for the evolution of institutions and organisations. Institutional economics endeavours to allow for more complex motivations and modes of decision making than does traditional economics. The decision maker in traditional microeconomics is a maximiser of economic self-interest and capable of complex computations with full information. The decision maker within an institutional economist's model may be motivated by altruism and self-sacrifice as well as, or instead of, personal gain. The decision maker is groping in the half-light of expensive and possibly distorted information and may be relying on conventions, traditional procedures, norms and preconceived constructs to make decisions. The economist, Ronald Coase, who received a Nobel prize for his contributions to the economics of institutions, remarked that "we should start with real institutions. Let us also start with man as he is".

In the debate over public sector reform in New Zealand, the issue of motivation of public organisations and individuals aroused a fair amount of controversy. Critics of the public sector management reforms argue that these theories imply that people may only be motivated by money and public institutions motivated by self-interest rather than public interest. It is not entirely clear whether the critics are arguing that this is not true or that it is ethically objectionable. Institutional economists also argue amongst themselves about the evidence of motivations. An example was a sharp debate within the Treasury in 1989 about the use of bonuses for performance. Some economists argued that money is a universal motivation that influences everyone. Others argued that the effect of bonuses was dependent on the particular circumstances within an organisation and that they might be counter-productive in an environment where individual performance is not easily determined and teamwork is essential for organisational performance.

To the institutional economist, self-interest can take many forms and not all are necessarily capable of being reduced to money terms.¹⁸ There is, however, a disbelief in the proposition that organisations, either private or public, can always safely be assumed to act selflessly in the interests of

¹⁸ See Douglass North, *Institutions, Institutional Change and Economic Performance*, Cambridge University Press, Cambridge, 1990, ch 3 for a discussion of the behavioural assumptions in institutional theory.

shareholders or citizens. Even if such an assumption were discovered to be broadly consistent with the evidence, there would still be the problem of bounded rationality, where people could do the wrong things for the right reasons. Further, while it is one thing to be motivated in one's mind by the public interest, it is quite another thing to be sure what this actually is in particular circumstances. Having spent five years negotiating the details of the transactions between the former health authorities and the public hospitals, I can attest to evidence of horizontally opposed views of the public interest by people with only very muted personal financial incentives. I can also attest to the failure of attempts by ministers to use their authority over the parties to impose a single view of the public interest. These were not cases of naughty school children needing to see common sense, but examples of the difficulty of designing relationships and institutions that clarified and resolved real trade-offs between conflicting public interests.

There is an application of institutional economics that has been glorified with the title 'agency theory'. Agency theory is a particular branch of institutional analysis that examines the problems of designing the rules of a relationship between a person with authority, known as the principal, and a person employed to carry out some function on behalf of the principal, known as the agent. Agency theory establishes the concept of agency costs, the transaction costs associated with designing, implementing, monitoring and enforcing the rules of the relationship. These costs can also include the deadweight costs from wrong decisions, due to bounded rationality or weaknesses in the design and implementation of the relationship. The task of the agency theorists is to design relationships that minimise agency costs, another critical consideration in designing structures and functions in the government sector.

The application of institutional economics to the relationship between shareholders, directors and managers has been very influential in the private sector internationally in recent years. The results were adapted for use in state-owned enterprise policy in New Zealand and have been copied, usually badly, in various other countries. The Harvard Business School economist Michael Jensen and numerous other institutional economists have examined the chain of accountability from shareholders through directors to managers with increasing sophistication. They have developed the basic idea of agency theory into a sophisticated analysis of relationships, incentives and information in a market environment and have backed this up with empirical methods. The New York firm Stern Stewart pioneered the method known as 'economic value added' that is used internationally as a

technique to align the interests of managers and directors with those of their shareholders in applying the principles of agency theory. This approach was pioneered by the Airways Corporation for use in the New Zealand public sector and is now used by other state-owned enterprises to align managers' incentives to the interests of the shareholding ministers.

Other institutional economists have endeavoured to expand the analysis of relationships between shareholders, directors and managers to incorporate lines of accountability of various agents to other principals or so-called 'stakeholders'. The analysis is capable of addressing issues in the design of worker co-operatives, trade unions and other institutions of civil society, including producer boards and the plethora of public institutions. However, the analysis of these institutions has had only a fraction of the attention that is being paid to the analysis of what is called, in the seminal work of Oliver Williamson, *The Economic Institutions of Capitalism*.¹⁹

A further refinement of the theory has been the emergence of concepts that attempt to encompass classes of influences on transaction costs that arise from the fact that individuals decide on their actions within a social context. They may do this either within a particular formal institution with an organisational culture, a class of similar institutions or within an informal affinity group that nevertheless shares a lot in common. It could be anything from an internet chat group to a Masonic lodge, religion, race or nation state.

The terms that have been coined in an attempt to begin to analyse these influences are 'social capital' and 'cultural capital'. Robert Putnam²⁰ has written on the former and George Barker,²¹ in this country, has written about cultural capital and some of its implications for policy. Critics dislike the rational 'econspeak' that they see in these terms but they are an attempt to define assets that lower transaction costs, which are not captured within a single institutional design, but lie in the background context of many transactions and relationships. Such assets evolve over time, and may be created and destroyed. They have a role in supporting the implementation of many government policies.

¹⁹ Oliver Williamson, *The Economic Institutions of Capitalism*, The Free Press, New York, 1985.

²⁰ Robert D Putnam, *Making Democracy Work: Civic Traditions in Modern Italy*, Princetown University Press, Princetown, 1993.

²¹ Dr George R Barker, *Cultural Capital and Policy*, Centre for Law and Economics, Australian National University, Wellington, 2000.

A central proposition of institutional economics is that more efficient institutional frameworks do not necessarily drive out inefficient ones. (This contrasts with the theory of competitive private markets.) The contemporary focus on institutional analysis and reform in the work of the international economic institutions is founded on the concern that poor countries have many stable, enduring institutions that are clearly not aligned with the public welfare. All countries have some such institutions and institutional analysis is, therefore, concerned with evaluating how institutions and organisations align with the purposes they are intended to serve and with the public interest more widely.

While considerable progress was made in analytical ideas grounded in institutional economics, economics was not alone in contributing ideas to the New Zealand reforms. Evolution in public sector accounting doctrines led to the changes from cash-based accounting to accrual accounting and from input-based budgeting to output-based budgeting.²²

A part of the international debates over the new public management are the conflicting views on the place of performance specification, performance agreements and contract-like arrangements. There is an ideological element to this debate. Because these methods sometimes clarify policy issues and options concerning downsizing, contracting out, corporatising or privatising government functions they are disliked by some on the political left which sees them as biasing governments towards those policies. The ideological arguments are, however, peripheral to important issues about the effectiveness of various management methods in co-ordinating the work of ministers, top executives and operational staff in the pursuit of organisational goals. The tools of institutional analysis provide insights into management methods.

In his review of the system for the government, Professor Schick recognised the value of institutional economics for the public sector:

... institutional economics and the array of ideas that have given rise to contractual theory provide powerful insights into the structure and operation of private and public organisations. They have spurred the infusion of modern business practices into the public sector and have also added muscle to accountability arrangements.²³

²² An exposition of the analytical bases of some advice on public sector reform in the late 1980s is contained in Scott and Gorringer, *op cit*, p 27.

²³ Schick, *op cit*, p 24.

James Q Wilson has written about the relationship between alternative management methods and the degree to which outputs and/or outcomes for the service in question are observable. Given his prominent influence in the literature it is pertinent to discuss his views here. His perspective is captured in this paragraph:

Given the constraints on managers of public agencies, it is a wonder that there is any management at all. Managers are supposed to co-ordinate the work of operators to attain organisational goals. For managers to do this properly the goals must be known, the work must contribute to their attainment, and the powers of managers must be sufficient to produce needed co-ordination ... these conditions rarely are met in public agencies; often goals are hopelessly vague, activities sadly ineffectual, and powers sharply limited ... Nonetheless, managers do make things happen.²⁴

He continues:

Under these conditions of vague or conflicting goals, multiple principals and bureaucrats with policy preferences it is hardly surprising that economists have not made much progress in finding even theoretical solutions to the problems of shirking. What is surprising is that bureaucrats work at all rather than shirk at every opportunity ... How can this be?

His answer to this last question is that bureaucrats are motivated by non-pecuniary rewards as well as pecuniary ones. There is a sense of duty and purpose, the status that derives from individual recognition and personal power and the benefits of associating with an organisation (or a small group within it) that is highly regarded by its members or wider society. Using US federal government examples, Wilson asserts that some public managers use these rewards to create a sense of mission but some do not and this is commonly due to conflicting goals. However, even for bureaucracies with no sense of mission, most do not have major problems with shirking.

Wilson sees systematic differences in the way agencies get operators to do what they are supposed to do. How managers manage depends on how observable are the outputs and outcomes and there are four possibilities.

First, a 'production organisation' is one in which both outputs and outcomes are observable. He cites the US Internal Revenue Service as one example. The conditions are relatively favourable to achieving outcomes efficiently. His examples show, however, that this is by no means certain.

²⁴ James Q Wilson, *Bureaucracy: What government agencies do and why they do it*, Basic Books, New York, 1989, pp xiv, 433.

Secondly, a 'procedural organisation' is one in which managers can observe the outputs but not the outcomes. An army in peace time is an example. How operators go about their jobs is more important than whether they are achieving anything. Accountability is about conformity with procedures and staying within constraints. This changes rapidly when outcomes become apparent as, for example, when an army goes to war.

Thirdly, a 'craft organisation' is one in which the activities of operators are hard to observe, but the outcomes are relatively observable. This promotes goal-oriented management and can be seen in investigatory functions and civil engineering in remote locations. Such organisations rely on the ethos and sense of duty to control behaviour.

Fourthly, there are 'coping organisations' where neither outputs nor outcomes are observable, such as public schools and the maintenance of order by police. Coping organisations in the private sector may grope towards success by trial and error, but public ones may not even do this. Managers make a difference in coping organisations by, for example, being able to attract superior staff even though the definition of superior is very fuzzy.

Coping organisations are characterised by conflict as operators respond to their immediate situations and managers are driven by constraints and by addressing external political issues. They will try to control operators through whatever objective variables they can find and give them only very limited freedom of action. Effective management is almost impossible and operators feel unsupported.

Wilson concludes that the principal challenge for managers is to define the core tasks of an organisation and use pecuniary and non-pecuniary rewards to induce operators to perform them well. Ambiguity about performance is managed by creating a supportive culture through formal and informal socialisation. This is very hard to do in an organisation with no sense of mission. The mix of approaches will be different among the four types of organisation.

Wilson's treatment of this issue provides useful insights, although a deeper analytical framework could take the analysis further. His general conclusion invites the questions about how managers are to define core tasks (or even whether it is their responsibility) and what are the most effective ways to establish a supportive culture. His invocation of institutional economics in this piece stops with agency theory and lacks the broader perspective noted earlier in this chapter.

In the remainder of this book I respond to the questions that arise from Wilson's discussion amongst many others. How, and by whom, are performance objectives set? What are the formalities and informalities in the relationships between the parties to an agreement about performance? What are the structures, processes and legal requirements about performance information? How are distortions to the behaviour of operators minimised? How are the coping organisations to be made easier to manage and more effective? What are the factors that promote the development of a sense of mission and a culture that addresses performance ambiguity?

In extending the model out beyond the ministries and departments to the Crown entities, I consider what can be done with 'relationship agreements', strategic co-ordination, better statements of intent and so on to align the government's operations better with its strategic intent.

Public institutions and their processes do not fall easily into simple categories in terms of institutional economics. There is no simple way to allocate government functions into standard forms of organisation. The organisational forms of ministries, departments, Crown entities and SOEs are very flexible and overlap. The police and the military are different again. Matching form with function requires attention to detail. This point is addressed in chapter ten.

The path to greater efficiency and effectiveness often involves delegation of authority, within constraints, to lower levels within government. In these circumstances agency theory is helpful in thinking about improvements. This theory is concerned with optimising the transactions involved between the superior and subordinate levels of public management when the goal is to allocate decision rights to the party with the best capability, information and incentives to achieve performance goals. Finely detailed restrictions on the discretionary powers of departments and managers would be widely seen as undermining performance in such activities. Senior civil servants and advisory boards of Crown entities sometimes work in areas where they need to consider complex information and heterogeneous circumstances and to be trusted to make decisions. In large organisations effectiveness requires that these delegations must pass down the management line. There are, however, qualifications to this delegation.

It is useful in this respect to distinguish management from administration. There are parts of the government where close attention to the implementation of detailed laws and regulations, without much discretion, is an efficient way of implementing a policy. Arguably the select committee enquiry in 1999 into the Inland Revenue Department was about

how much discretion revenue officials should have in the implementation of the tax law. Public opinion, as represented by the politicians leading this enquiry, wanted these officials to take a softer line with taxpayers. If they did, however, it is entirely predictable that the minister of finance would be demanding that they tighten up again. This case is discussed in chapter 11. Where the details of how a function is performed are very significant, controls by ministers and the law and transparency about the parameters of discretion in implementing the law are warranted.

All government organisations operate in an environment of multiple accountabilities and requirements to consult various parties, including requirements under policy and public law to take account of public opinion on specific issues. There is rarely a neat answer to the problem of confused and conflicting requirements that this can create. It is productive, however, to clarify and order these to the extent this is practical and produces a net benefit in terms of the costs involved. There can be real benefit in analysing thoroughly the allocation of decision rights that are involved in requirements placed on public managers, either by ministers or in law, to consult or negotiate with citizens and community groups. Failure to do this often results in disappointment, political controversy and legal expense where judicial review takes place. There is a particular danger with the rhetorical emphasis on partnerships rather than performance agreements and contracts within the Labour/Alliance government. Lack of clarity about the rights and responsibilities of the parties will cause a disappointing confrontation between rising community expectations for more funds, with fewer strings attached, and the reality of parliamentary accountability for public money.

Finally, how should the mix of elements in public management be adjusted to suit the different character of various public services in Wilson's terms and more widely?

THE INFLUENCE OF THEORY ON PRACTICE

How much did these theories influence the changes to public sector management in the 1980s and 1990s? As Jonathan Boston has observed:

Assessing the influence of particular ideas, assumptions, theories and models on a series of policy changes poses many difficulties. In any given policy setting there are usually numerous forces at work, not to mention a range of political, institutional and technical constraints. In most situations, therefore, it is impossible to ascertain with any precision the impact of specific ideas, theoretical insights, or schools of thought on the process of policy development and implementation. This is certainly the case when it comes to assessing the

influence of the various theoretical approaches ... on New Zealand's public sector reforms. That they were influential there can be no doubt. But precisely when, where, and to what extent they made a difference is much harder to determine.²⁵

New Zealand's politicians drove the reforms for practical reasons. The newly elected Labour government of 1984 had powerful forces for change in the combination of a fiscal squeeze and capable ministers enthusiastic to improve the performance of the economy and government. Economic growth was low, debt and inflation were rising, there was a large fiscal deficit, and the economy was caught in a web of distorting industry subsidies and regulation. The government was a large player in the economy, supplying many goods and services that were considered by some politicians to be better provided by the private sector such as telecommunications, railways, airline services, construction, farming and forestry. Concerns about the quality of policy advice, inefficient government enterprises, the level of government spending and a lack of accountability in the large bureaucracy fuelled a desire for change.

Some of the ideas of these reforming politicians had theoretical underpinnings, as one can see from their publications. The politicians were supported by officials who grounded their advice in ideas from institutional economics, accounting and management theory. As well as drawing on the conceptual elements of theories from these disciplines, advisers were able to use these disciplines to provide new insights into evidence from the past, both good and bad, that was revealed as the years passed by. This was not always so, because the analytical methods were evolving. Also, it is one thing for theory to provide a rationale for advice *ex post* and another for it to be the actual source of the advice *ex ante*. A lot of what is widely considered to be good management practice is consistent with economic principles, but arises from the practical experiences of professional managers who are uninterested in those principles.

Theoretical analysis has a contribution to make alongside practical insight to advance the concepts of what constitutes good public management and how to promote it. Institutional analysis has provided useful insights and practical tools to use in designing the institutions that are intended to give effect to government policies. If this is to continue in the future, politicians need to ask for thorough analysis of options and officials need to employ and improve their analytical techniques. In so doing, practice will inform theory

²⁵ Boston *et al*, *op cit*, p 26.

and the analytical frameworks will develop to meet the increasingly more difficult challenges of tuning the public sector to perform better.

Public institutions sit in a network of relationships that run within and across organisations in all directions. If we do not accept this complexity, learn the lessons of experience and design institutions accordingly, then we are doomed to keep re-learning the same lessons and to keep hobbling our potential to reach standards of excellence in public sector management.

Understanding the interactions of incentives, information, capability and culture in particular institutional settings is painstaking work. Oliver Williamson has said that the work of institutional analysis is, like archaeology, detailed. Practical politicians and their advisers cannot wait, however, for the last piece of dust to be brushed off the hieroglyphs. They must take risks and try things that may not work out. But these risks should be calculated risks, supported by analysis, not driven by uninformed pragmatism or thoughtless ideology. Our public institutions could evolve over time to be the best anywhere in the world but this depends on whether successive governments learn, not only from their own successes and failures, but from those of the governments that have gone before them.

3

SETTING AN AGENDA FOR ASSESSING THE REFORMS

INTRODUCTION

This chapter summarises the main points of support and criticism of the reformed public management system that arise in two reviews that were commissioned by the government and in a selection of commentaries by academics and other observers. The chapter concludes by setting an agenda for the rest of the book.

CRITIQUE OF CONTRACTS AND MANAGEMENT

The interest that reformers had in introducing new techniques of management to the public sector through eclectic borrowings and adaptation of related private sector management techniques has, surprisingly, generated strong controversy. Some observers of the management system have described this as 'managerialism',²⁶ which they characterise as an uncritical belief that private sector management is superior to public sector management and that it should be introduced throughout the public sector. Some commentators go further and trace the roots of managerialism back to the mass production techniques introduced into the automobile industry in the 1920s. The centralisation of control over production that this entailed is then associated with the emergence of performance agreements in New Zealand's public management.

Ministers and managers in the public service, who have never taken the extreme view of the superiority of private sector management techniques in the definition of managerialism, have never to my knowledge taken the criticism seriously. As Boston *et al* observed:

... it was never assumed by those guiding the reforms that private sector management practices should be applied automatically, uncritically, or comprehensively to the public sector.²⁷

²⁶ A summary of points that come from the definition of managerialism by various writers can be found in Boston *et al*, *op cit*, p 26.

²⁷ Boston *et al*, *op cit*, p 39.

Also, the characterisation of the reform as centralising power, strikes practitioners and reformers oddly, because their experience was that the various authorities to make decisions were predominantly devolved by the reforms.

There has always been a lack of clarity and strongly contrasting views on this point. Reformers saw the changes as responding in part to excessive use of power by prime ministers and cabinets through delegations and transparency. Critics appear to be arguing that the decentralisation was conferred on the wrong people – boards and managers. The preference of the critics is to delegate to professionals in the form of teachers, doctors and so on, rather than to managers. This is a red herring and, as I have argued elsewhere,²⁸ a competent leader in any public organisation (or private one for that matter) has to have both organisational skills and technical understanding of the services the organisation is producing. Critics have also suggested that too much ‘managerialism’ could encourage poor behaviour. The state services commissioner addressed this argument in the annual report for 2000:

There is an urban myth that too much ‘managerialism’ has created an environment in which unethical or corrupt behaviour is more likely. Proponents of this argument hold that private sector practices such as the wide delegation of authority for expenditure, and contracting-out a range of services rather than maintaining in-house capability, create a more risky environment than highly centralised, rule-bound administration. I have seen no compelling evidence that this is the case.²⁹

The commissioner noted that New Zealand ranked third out of 90 countries in Transparency International’s Year 2000 ratings of perceived levels of corruption in both the public and private sectors, slightly behind Finland and Denmark.³⁰ The rare instances of prosecution for corruption by public servants in New Zealand have been for taking bribes in exchange for regulatory permissions and for releasing personal information. These have no apparent link to the delegation of management authority.

Critics have also focused on the instruments of delegation and the decision rights and accountabilities contained in them. The reforms have

²⁸ Graham Scott and Roger Blakeley, “Professionalism in the Public Service”, Public Service conference, Wellington, 9 September, 1993.

²⁹ State Services Commission, *Annual Report for the Year Ended 30 June, 2000*, p 4.

³⁰ Transparency International, *Year 2000 Corruption Perceptions Index*, Berlin, 13 September, 2000.

produced an enormous range of contracts between the centre of government and providers of services to the public of all kinds. Critics dislike the formality of this arrangement, some of the details in the contracts and what they assume to be the power relationship inherent in them. They prefer 'dumb funding' of hospitals and primary medical care, for example, rather than payments for services delivered. They prefer the language of 'partnerships' rather than 'contracts'. The government that was elected in 1999 is determinedly trying to change the language of its relationships with providers and communities as the Blair administration has done in the United Kingdom – for example, hospital contracts are now called 'commissions'. The term partnership is going to be widely used but as a label rather than legal instrument. This is likely to fade as an issue over time because much of the criticism of these contractual relationships is due to some very clumsy contracts being imposed by public organisations that lacked the skills to do this properly.

Six years as chairman of three health funding entities showed me that several years of trial and error by both parties are needed to get a stable, informed and familiar process for reaching agreement on objectives and funding flows. Some critics want funds to pass to providers and communities with few if any strings attached. If this is tried it will not last long. Almost a millennium of constitutional experience establishes the principle that the executive can only lawfully spend money on the basis of appropriation by parliament, which requires the auditor-general to be satisfied that funds are spent on the purposes for which they were appropriated. It is barely conceivable that parliament would change the law so as to permit the executive to allocate funds to public or private providers of services without establishing a chain of accountability for, and reporting on, what the funds were spent on. Some people may not want to use the word 'contract' to describe a document that records an agreement to spend money on a specified purpose with a legal entity that is separate from the government. But longstanding constitutional provisions, together with the continuing demands by parliament for financial accountability of the executive, set a limit on just how dumb funding can be. This limit, plus the growing skill and reliability in establishing purchasing and funding relationships, promises a narrowing of the gap between proponents and opponents of contracting.

There are critics who seem to object to the whole idea of management and attack managerialism from an ethical and ideological perspective. Some of these points are taken up in the next sections. They are also apparent in

speeches made by some senior ministers in the 1999 Labour/Alliance government.

These statements suggest that the agreements to provide outputs failed to capture other important aspects such as trust, goodwill and open communication.³¹ The attorney-general describes a chief executive's position in relation to inputs and outputs in the following way:

... if I am a departmental chief executive contracted to process x number of things a year, and to do so at a particular price, in order to achieve that, I should have discretion to make decisions about the inputs that I use for that. While this appears to place a great deal of trust in chief executives, such contractual procedures, as I have mentioned, are more suited to low-trust relationships than the high-trust relationships we seek.³²

Is it true in reality that ministers, boards and managers think it is necessary to have an agreement about what is to be provided for the resources expended only when there is low trust between the parties? I suspect that this was news to people in public and private sectors alike. Most experienced business people enter into contracts only with parties they trust. No contract is ever complete and experience teaches us not to have a contract with a party who will be looking for loopholes and behaving opportunistically when unanticipated events arise. The HFA, which was the largest contracting organisation in the government before its abolition, was concerned to ensure that organisations could be trusted to honour their obligations before it was willing to enter into contracts for the provision of health services. Clarity over expectations is a key component of successful relationships in most areas of life and, in my experience, most definitely in the relationships between governments and organisations in receipt of public money.

The quotation above creates an impression that the agreements between ministers and chief executives were confined to outputs. The agreements with 'responsible ministers', as well as including a requirement to deliver outputs, cover many things, such as the contributions to government goals, relationships with other organisations, future capability and personal performance matters. The agreements also include the state service commissioner's detailed expectations on standards to be met. The purchase agreements and performance agreements form part of a wider management environment for chief executives that include statutory duties, conventions,

³¹ Hon Margaret Wilson, attorney-general, speech to the New Zealand Legal Research Foundation, "Critiquing the New State Sector", 21 September, 2000.

³² *Ibid*, p 8.

policy requirements and the nature of their relationships with ministers and the monitoring agencies.

The attorney-general suggests that the “list of output targets achieved is not nearly as important [to the public] as the knowledge that their affairs are being handled – dare I say it – in good faith by those paid to do so”.³³ Of course, people waiting for surgery want to know that their cases are being handled in good faith, but they also want to be sure that they get the surgery, that is, the output.

The minister of state services, the Hon Trevor Mallard, has suggested that “we need to change the mode of thinking that relies on very narrow contracts to drive and motivate people to co-operate and deliver results”.³⁴ As noted above, this is not an accurate statement of what the agreements are intended to cover. Also, the agreements are not the only aspect of the governance and accountability arrangements. Account is not taken of the wider environment in which these agreements operate. It is a very inaccurate statement of the ‘mode of thinking’ that has evolved over 12 years. Nevertheless, it is an authoritative statement by the minister. His perspective is addressed in the following chapters.

Further, if the performance requirements for public organisations are not well expressed at the beginning of the year then the auditor-general cannot comment sensibly on the statement of service performance at the end of the year – so public accountability is weakened in this respect. The parliament in 2000 considered a law empowering the auditor-general to audit performance by public organisations. The auditor-general, when conducting these audits, will no doubt insist on clear expressions of performance requirements in order to avoid having to imagine in hindsight what they might have been.

There is a drift in the thinking of some ministers in the current government towards diminishing or dropping the effort being made for clear expression of the results public organisations and publicly funded contractors are intended to pursue. We can expect the auditor-general to resist this, and so that authority should.

I have emphasised elsewhere the importance of simplification and refinement of performance and accountability expectations to promote effectiveness, reduce costs and minimise distortion. This includes attention

³³ Wilson, *op cit*, p 12.

³⁴ Hon Trevor Mallard, minister of state services, “Complying with the new government’s priorities and plans for improving public sector performance and accountability”, speech to the Public Sector Performance 2000 conference, 3 May, 2000.

to the ethics, standards, trust and relationships that governments have been emphasising. One of the core issues of contention in debate over public management is whether these are improved or diminished by providing for greater explicitness in performance expectations in terms of outputs, outcomes and resource use. Many departmental performance agreements, statements of intent and contracts with arm's-length service providers have been inadequate and a few were worse than having nothing at all.

Professor Allen Schick, whose critique is considered below, expressed reservations about aspects of what has been spawned from the use of institutional economics, which he characterises as hard-edged contractualism. He has suggested a "softening of the rigidities of management by contract".³⁵

This suggestion poses a choice between pragmatic modification of some techniques versus development of theory and practice to account for observable weakness or failure in earlier models. I think that pragmatism has an important place but too much would lead to incoherence over time. A greater effort than has been in evidence in evaluating management systems and more attention to developing and testing theoretical models is desirable.

REVIEWS OF THE SYSTEM

Like many governments, the New Zealand government has not undertaken large-scale empirical evaluations across the entire government to assess changes in performance over time. The reforms set off the work required to understand what government agencies produced, for what cost and how well they were set up for maintaining and developing their capability into the future. Information to assess changes in performance and capability is increasingly becoming available.

A World Bank study in 1996 concluded that:

... the public management system has contributed to macro-economic fiscal objectives, efficiency objectives and the shifting of priorities, but perhaps less on the last of these by comparison with Australia's reforms.³⁶

A 1996 study by Brumby *et al* provided evidence of substantial improvements in the production efficiency of some standard administrative

³⁵ Schick *op cit*, p 26.

³⁶ Ed Campos and Sanjay Pradham, "Budgetary Institutions and Expenditure Outcomes: Binding Governments to Fiscal Performance", *World Bank Policy Research Working Paper* 1646, September 1996.

services.³⁷ This assessed the effects in relation to achievements in three stated goals recorded in government budget statements, the State Sector Act 1988 and advice from the Treasury:

- enabling governments to control aggregate expenditure better;
- better align expenditure with government objectives;
- improve productive efficiency of service delivery.

The method of the study looked at measurable financial variables and other data relevant to determining whether the specified goals of the reforms had been achieved. In particular, the study assessed the reforms in relation to movements in fiscal variables, changes in the composition of expenditure and changes in the unit costs of standard services if these characteristics did not change over the period of reform. The major conclusions of the study were:

- the evidence of central government expenditure is consistent with, although it does not conclusively establish, financial management reform (FMR) having made it easier to control public expenditure;
- there is insufficient evidence at this stage to form a judgement concerning the contribution of FMRs to improving prioritisation;
- the unit cost evidence can reasonably be interpreted as providing a measure of support for the proposition of improved productivity performance in departments.

Beneath these carefully worded conclusions is the fact that, at the time of the introduction of the reforms, financial net expenditure fell by 3.7 percent over three years. This produced a fall in financial net expenditure as a share of gross domestic product (GDP) that was unprecedented over the previous 20 years. The unit cost measures were subject to sample bias in drawing any inferences for net cost over the government as a whole, but were dramatic insofar as that sample is concerned. For example, the fall in average unit costs for certain functions in Valuation New Zealand was between 10 percent and 20 percent in nominal terms over five years for a range of estimates. The New Zealand Immigration Service accommodated a 25+ percent output increase over three years within a 2 percent increase in nominal expenditure. The Income Support Service increased the volume of applications it pro-

³⁷ Jim Brumby, Peter Edmonds and Kim Honeyfield, "Effects of Public Sector Financial Management Reform (FMR) in New Zealand", paper presented to Australasian Evaluation Society conference, 30 August, 1996.

cessed by 60 percent over two years with barely any increase in operating expenses.

All such studies are qualified by their inability to distinguish between the effects of political will to implement stated fiscal objectives from the effects of management and information system changes. It is relevant in this context to note that ministers and officials working on budgets throughout the period of change believed the system facilitated the achievement of their stated objectives. Survey information of central agencies and chief executives in the government support this contention. One such statement comes from the minister of finance between 1990 and 1993, Ruth Richardson:

The new focus on outputs brought about by the Act meant ministers had genuinely meaningful information about the services produced by their departments and were in a position to make informed trade-offs between competing priorities. Our exercise was the first genuine yield from the Public Finance Act.³⁸

Audit Office and State Services Commission reviews

A 1998 report by the Audit Office considered the state of the financial reporting and financial management systems in the core public sector.³⁹ The report indicated general satisfaction with the financial and service performance information and control systems. All 44 government departments received unqualified audit reports.

Capability assessments by the SSC in 1998 placed five departments and ministries on a watch list, six on baseline review, and three on output pricing review, with three cross-agency areas listed for the machinery of government exercises. A considerable number of agencies, about 30 percent, were positioned somewhere off the 'general monitoring' category and were dispersed across the continuum from the 'watch list' to the 'machinery of government exercises'.⁴⁰ Some of these agencies provide a significant portion of the government's services and have a significant impact on the functioning of the state sector and on the community, for example, Work and Income Support, Department of Social Welfare, and the Ministry of Education. This indicates a reasonably large degree of risk in the area of capability.

³⁸ Ruth Richardson, *Making a Difference*, Shoal Bay Press Ltd, Christchurch, 1995, p 103.

³⁹ Audit Office, *Government Departments: Results of 1997/98 Audits*, Wellington, 1999.

⁴⁰ State Services Commission, *Future Application of Output Pricing Reviews: Strategic Fit, Application Paths and Development Options*, Wellington, 1998, p 11.

Information on two areas of capability, strategic planning and risk management, indicate that departments have some way to go with this work. In 1995/96 only 49 percent of core government departments had fully operational strategic business plans. This had risen to 68 percent by 1997/98. This indicates that some departments may still lack plans and that many do not have a long track record in the development and use of these plans.⁴¹ Risk management through self-review was employed in about 80 percent of departments in 1998. Formal risk management was fully operational in less than 40 percent of departments in 1996/97 and 70 percent by 1997/98.⁴²

These reviews indicate that work on financial systems is more advanced than other areas affecting capability, such as planning and risk management. These topics are taken up in chapters eight and 11.

Individual department reviews

Virtually every department has had at least one major review since 1988. Many, especially those producing goods and services for sale, had been radically restructured before then. In each case recommendations were made to improve performance by applying common principles with adaptations to specific circumstances.

Some of the themes and conclusions of the reviews have remained remarkably consistent. In particular, there has been a continuing emphasis on issues such as:

- the clarification and specification of objectives;
- the quality of policy advice;
- separation of distinct and potentially conflicting roles, for example, operational activities versus the provision of advice on what those activities should be, or how, and by whom, they should be carried out;
- horizontal co-ordination;
- the provision of contestable policy advice and the establishment of contractual and contestable arrangements between different agencies;
- the transfer of appropriate functions to non-departmental Crown entities, state-owned enterprises, or the private sector; and
- the efficiency with which departments are carrying out their functions.

⁴¹ State Services Commission, *Draft: Collation of Public Service Departmental Performance Assessments Year Ending June 1998*, Wellington, 1998.

⁴² State Services Commission, *loc cit.*

Each of these points is taken up in the following chapters.

As well as reviews of aspects of the system, the government commissioned two wide-ranging studies, the Logan report in 1991⁴³ and the Schick report in 1996.⁴⁴ These reviews were generally strong in their support for the reforms, although sharply critical of areas of weakness in concepts and operations. There is also a substantial and growing literature that has described, criticised and evaluated the reforms from a variety of points of view.⁴⁵

The Logan report and subsequent actions

The Logan report⁴⁶ endorsed the overall framework for reform and found that substantial benefits were being achieved.

In the view of most people we spoke to or heard from, the framework of the reforms is sound and substantial benefits are being realised. We were particularly impressed with the very positive reaction from senior managers. Their view, supported by Ministers and other observers, is that performance has improved in most key activities as a result of the reforms. A prime example was the way in which departments were able to respond to the pressures of the demanding 1991 Budget process. However, we did find some significant issues in the way the reforms are being implemented which need attention.

The review group also sounded some warnings and made recommendations for improvement in respect of:

- the recruitment and development of top managers;
- ensuring that performance agreements were of a high standard
- strengthening incentives for improved performance; and
- strategic co-ordination of government-wide interests.

The government accepted the Logan report's conclusions, and launched task forces and other initiatives to address each of the main areas of recommendations. Below are very brief summaries of the points in the Logan

⁴³ Basil Logan, "Review of State Sector Reforms", *Steering Group Review of State Sector Reforms*, November 1991.

⁴⁴ Schick, *loc cit.*

⁴⁵ See, for example, Graham C Scott, "Government Reform in New Zealand", *International Monetary Fund Report* 140, October 1996; Jonathan Boston *et al*, *loc cit*; and Brian Easton, *The Commercialisation of New Zealand*, Auckland University Press, Auckland, 1997.

⁴⁶ Logan, *loc cit.*

report, together with some of the actions that were taken in the years immediately following it.

Recruitment

The report noted the problems encountered in finding new chief executives. The promised levels of compatibility between public and private sector pay had been eroded. The issue of falling levels of remuneration compared with the private sector continued to be an obstacle. Coupled with this, succession planning was weak. The review group identified the development of managers as a critical problem and urged the adoption of an effective service-wide framework to address this.

To improve the recruitment and development of top managers, the senior officials established the Management Development Centre, under the control of departmental chief executives. There was a long delay between Logan's recommendations and its establishment.

The Management Development Centre undertakes a variety of training and development functions but appears to lack the resources and the commitment of its constituents to allow it to achieve its mission fully. It is difficult for the Centre to overcome this lack of commitment and resources on its own. Development activities require the commitment of top managers across departments and, while some of the most senior and experienced chief executives have demonstrated their commitment, there are others who are rather indifferent.

There are debates regarding the concepts and philosophy of training for senior public servants and how these differ from the private sector. Such questions should not be at issue after all the years of experience with the training of top management in the public sector. Nevertheless, the Management Development Centre is a convenient forum in which to consider such issues.

There are still senior human resources matters that have not been resolved adequately either in the aftermath of the Logan report or since. These questions are addressed in chapter nine.

Performance

The review group also expressed concern over serious inadequacies in performance specifications and in ministerial indifference to establishing performance requirements in some areas.

The Logan report was written at a time when some of the outgoing Labour ministers had not bothered with performance agreements, and their

chief executives had not used their positions to insist on them, despite this being government policy. Some incoming National ministers were similarly uninterested. However, the ministers of finance and state services insisted this be done, and the performance agreement system was fully implemented. There have been continual efforts to refine and develop the agreements, led by the Treasury in some cases, and also through a group of chief executives. Performance agreements for chief executives are not readily available for scrutiny, but fragmentary evidence suggests that there is a wide range of quality, substance, and varying degrees of commitment in them. I have seen some agreements that lacked focus and appeared to be a collection of projects without the coherence associated with a rational strategic business plan. Continuing attention will be required to adapt the performance agreements to new circumstances and to the lessons of experience.

On the whole, the system has not been developed to the point where Logan's concerns can be set aside, even though a lot of developmental work has been done both across the public service and, especially, within particular departments. Chapter seven considers these matters.

Incentives

Logan's concerns about the lack of performance incentives were partly related to the fact that there were few rewards for managers who achieved greater efficiency. If cost savings and surpluses could somehow be made into funding pools for staff rewards or new programmes, then the incentives would be strengthened. There is nothing, however, to stop the SSC from awarding bonuses to chief executives if they exceed targets, including efficiency targets. However, the awarding of bonuses is not generally done.

Nevertheless, chief executives, with oversight from their ministers, can fund new initiatives out of savings within performance agreements that have been set down with their ministers in the budget process. This can be achieved within output classes specified in the appropriation acts, subject to maximum limits. Anything beyond these limits can be presented to parliament in supplementary appropriation acts.

The system is, therefore, capable of providing stronger incentives to achieve efficiency and effectiveness goals than is possible through the constrained system of chief executive bonuses alone, although this capacity has generally not been fully utilised. The overarching government imperative to search for savings and to apply them to deficit reduction has created an expectation that all savings are moved to the central budget.

Strategic co-ordination

There has been a great deal of activity in strategic co-ordination since Logan reported concerns on this topic. There has been substantial response to these concerns through the development of concepts for setting strategic objectives for the government and chief executives, backed by planning processes. Politicians and top managers have made good progress in specifying areas of activity at the strategic level where the government is expecting some focus.

However, the system is lacking in important respects. It is weak in the quality and availability of research to specify achievable goals. The linkages between the expression of general strategic objectives in chief executives' performance agreements and the specifics they are obligated to provide in support of these objectives are weak. The detailed business plans to deliver them are also often weak. There is a general lack of information about performance to support internal and external evaluation and organisational learning.

There are numerous complex factors required for coherent policy and management co-ordination, and these factors have not been consistently in place. Despite a shaky start, the latter years of the Bolger government saw steady improvement in strategic co-ordination. The Shipley government began with a movement to raise co-ordination to new levels through cabinet procedures and conventions. These adjustments, while productive on their own, have not proved sufficient to provide a complete and robust strategic management cycle for the government as a whole. More attention is required. These issues are discussed in several chapters and in chapter 11 in particular.

The Schick report 1996

The thrust of the Schick report gave strong support to the reforms:

... it has become evident that the reforms have lived up to most of the lofty expectations held for them. The organisational cocoon of the old State sector has been broken up and structures reshaped through the application of the reforms' overriding principles. The State sector is more efficient, productive and responsive and there generally have been significant improvements in the quality of services provided to New Zealanders.⁴⁷

One does not have to search far for efficiency gains in the reformed State sector. Most departments have reduced staffing levels and operating budgets without

⁴⁷ Schick, *op cit*, executive summary.

lowering the volume or quality of public services ... these and other cost savings have been made possible by the reforms. They could not have been achieved if managers were still bound by *ex ante* controls enforced by central agencies.⁴⁸

There is near universal agreement that the New Zealand Government is much better managed now than before.⁴⁹

However, Schick qualified this:

Not every aspect of reform in New Zealand has worked out as expected. Although its reforms have been more comprehensive and rigorous than those introduced in other countries, they have been neither complete or perfect; their effectiveness has depended on the manner in which they have been implemented as well as underlying concepts and doctrines. This author has observed offices that have taken up the challenge and have thoroughly revamped their operations to improve performance, as well as offices that appear to be adrift and bereft of purpose.⁵⁰

What has been accomplished in New Zealand was unprecedented anywhere else in the world. There are risks, however, in pioneering in public management, including the risk of having to learn from one's own experiences, rather than those of others.⁵¹

Schick's consideration of the whole reform programme reveals an issue that concerns him but on which he is undecided. He sees negative as well as positive effects from the emphasis on clarity in the performance objectives that are set for public managers. The critical aspect of his commentary centres on the feasibility of a relationship between politicians and public servants based on hard-edged contractualism.

Having classified the system as contractualist, Schick is ambivalent about the language and concepts of contracting. On the one hand he states:

... the array of ideas that have given rise to contractual theory provide powerful insights into the structure and operation of private and public organisations. They have spurred the infusion of modern business practices into the public sector and have also added muscle to accountability arrangements. They have enabled reformers to comprehend how structure retards or facilitates performance and to view public agencies as contracting – rather than merely as producing – entities.⁵²

⁴⁸ Schick, *op cit*, p 4.

⁴⁹ Schick, *op cit*, p 7.

⁵⁰ Schick, *op cit*, p 3.

⁵¹ Schick, *op cit*, p 9.

⁵² Schick, *op cit*, p 24.

On the other hand he sees shortcomings that have arisen on the back of these ideas. Schick sees the relationship between chief executives and ministers as inevitably fuzzy in an environment where ministers carry political risk for the managerial discretion exercised by chief executives. In his opinion, emphasis on what he sees as bilateralism caused by performance specification may be the source of certain problems in the system. These problems are:

- the failure of the senior executive service;
- tight restrictions on the freedoms of managers to shift funds between specified outputs;
- difficulties in implementing practical ways to emphasise outcomes in performance requirements;
- high transaction costs associated with the operation of systems despite attempts to minimise and refine these requirements;
- possible reduction in public-regarding values and behaviour and the potential development of a 'checklist' mentality where focus is placed on specified items at the expense of non-specified ones; and
- weaknesses in senior manager development.

Having flagged these problems at the beginning of his report, Schick's later sections either dispose of some of these issues or lower his levels of concern on others. Specifically, he concludes that transaction costs are lower than the deadweight costs of the previous management system, although he remains concerned to ensure that the transaction costs are kept to a minimum. While worried over the ethical commitment to the collective interest of the government conceptually, Schick concludes that it is not a problem:

I believe that regard for collective values remains unusually relevant and valued in New Zealand.⁵³

Schick's concern is, therefore, about tendencies in the system that could cause 'misalignment'⁵⁴ and not so much about what has been done as what has been left undone or what might happen in the future. He suggests that the reforms can be revitalised in the areas of strategic management, the resource base and accountability.

More specifically he proposes:

- less specification of outputs;

⁵³ Schick, *op cit*, p 25, see also p 45.

⁵⁴ Schick, *op cit*, p 3.

- selective input control;
- greater reliance on 'public regarding behaviour';
- the injection of a 'heavy dose of managerial values'.

Managerial values operate around a management framework, such as delegated accountabilities for producing agreed goods and services. The management framework that Schick suggests softens the edges of performance specification and accountability because of concerns for the softer side of management. The nub of the difference is captured in Schick's phrase "managerial innovation has a soft side which contractual arrangements seek to counter".⁵⁵ My view is that the two, the soft side of managerial innovation and contractual arrangements, can be brought into alignment, and, in fact, must be for high performance.

It seems to me that the extent to which a particular framework of performance specification and accountability can be described accurately as contractualism, let alone hard-edged, depends on how that framework is implemented in particular circumstances. I do not see that there is an inherent conflict between holding managers to account for specified performance and the public spiritedness of public servants.

I agree with Schick's concern for the importance of a strong culture of ethics and service to the public.

He advocates a greater emphasis on ownership issues for ministers, in addition to their roles in specifying what outputs their departments are to produce in an arm's-length manner. He considers that, until rigorous output costing systems are in place, there should be a limited return to input cost controls.

Schick views the overall management system as placing huge and critical demands on the performance of chief executives. He considers the recruitment and retention of talented chief executives as vital, as well as the development of a continuing supply of trained and public-spirited managers below the chief executive level.

He supports the continued involvement of the state services commissioner in the appointment and performance assessment of chief executives as being a legitimate manifestation of the collective interests of government. He advocates the development of a mode of accountability based on values, judgement and leadership, as well as the achievement of specified results.

⁵⁵ Schick, *op cit*, p 24.

Schick also sees a continuing role for the SSC in advising on issues concerning the machinery of government and other government-wide issues and in assessing the performance of departments and chief executives.

He emphasises the importance of human resource management, which he suggests requires a separate study, together with a strengthening of attention to the ownership issues surrounding departments.

Like other commentators, I share Schick's concerns about the lack of development of the concepts and processes for ensuring that attention focuses on the ownership interests of government. Although there is limited evidence, there is enough reason for concern that departments are under-capitalised and that they are not building the human capital and developing the organisational culture needed to ensure improvements can be made to their services. This is discussed in chapter eight.

I also agree with Schick's call for more attention to human resource management and ownership issues in general. These matters are addressed in the following chapters.

Boston, Martin, Pallot and Walsh

In a book published in 1996,⁵⁶ Jonathan Boston, John Martin, June Pallot and Pat Walsh reviewed the public management system from the perspectives of theory, structure, management at the centre of government and in the periphery, biculturalism, human resources and what they called 'responsible management'. This is a thorough piece of work grounded in references to the international literature on public management. Some points that are relevant to the purpose of this chapter are as follows.

*Structural reorganisations*⁵⁷

Structural reorganisations within departments have brought improvements in productive efficiency and standards of service, greater contestability of advice and clearer organisational focus and mission. But there have been problems. Structural solutions have been applied to solving problems where cheaper solutions might have been available. By international standards New Zealand has a fragmented bureaucracy. Some organisational separations are associated with multiple reporting and monitoring functions. Contestability of supply of services might prove to be counter-productive where there are benefits from stable long-term institutions.

⁵⁶ Boston *et al*, *loc cit*.

⁵⁷ Boston *et al*, *op cit*, pp 87, 95.

Separating ownership from purchasing interests is dubious when both functions are the responsibility of ministers. The separation of policy from operations has generally worked but has also failed in some areas, notably defence. Concern over the capture of advice might be overdone. More generally, while it is desirable to have broad principles of organisational design they should be applied with circumspection and concern for evidence. The authors note the possibility of a shift in time away from a managerial paradigm of structure to one reflecting 'holistic governance'.

*Senior managers*⁵⁸

Boston *et al* reported on interviews with senior managers that the managers welcomed the changes in the management philosophy and accountability procedures and saw these as a marked improvement on the previous system. Two-thirds of the senior managers interviewed supported performance-linked remuneration and many felt they were more accountable because of it. The authors reported their concern over a tendency for chief executives to act in isolation and they noted the initiatives that were taken in the 1990s to address this. While seeing merit in the appointment system, the authors were concerned over the unanticipated emergence of the cabinet's rejection of a proposed appointment without the substitution of a politically appointed alternative. (This is discussed in chapter nine.) The authors were critical of the absence of an effective strategy for the development of senior management.

*Policy advice*⁵⁹

Boston *et al* saw as positive the flexibility of the new management arrangements to widen the range of sources of policy advice, together with the convention guiding the conduct of officials, including the requirement for free and frank advice. They regarded the latter as vital to the management of policy processes under the Mixed Member Proportional (MMP) electoral system. The authors noted problems in the lack of expertise in some policy fields and from some departments and reported concern over the Treasury dominance of policy.

⁵⁸ Boston *et al*, *op cit*, p 120.

⁵⁹ Boston *et al*, *op cit*, p 139.

*Public management in a bicultural society*⁶⁰

Boston *et al* noted the lack of consensus on how systems of government management should address the issues of Maori under the Treaty of Waitangi. Instability and reversals in government policy and deep divisions in philosophy made resolution difficult. On the one hand there were many senior managers who favoured greater self-government by iwi; on the other there were many who thought that separate governance structures were inimical to core liberal values and to national unity and social cohesion. Public managers faced many difficulties in being sensitive to the needs of all citizens in a multicultural society while responding to the special status and needs of Maori.

*Employment issues*⁶¹

The authors reported that unions and management believed that decentralisation of responsibility for human resources had been vital to the achievement of a range of reforms and would not want to return to the old system. Managers viewed the reforms more favourably than employees did, however. There were concerns expressed by the senior managers over how well middle managers were trained to take on their human resources (HR) responsibilities. The authors referred to writers who argued that horizontal synergies across organisations were valuable and questioned whether the decentralised system was the best way to make strategic use of the human resources potential.

The authors noted that public sector wages rose after the initial implementation of the management system but that the government maintained a very tight rein on them through the 1990s as a matter of policy. The tension between the expectations of the government on the SSC to act as the agent of the government in public sector employment and the expectations of managers that they could deal with HR responsibilities in a devolved way, played out slowly through practical accommodations. The degree of unionisation did not change much in the public sector, although unions perhaps lost some standing with members. Equal employment opportunity policy became firmly embedded in practices and culture.

⁶⁰ Boston *et al*, *op cit*, p 159.

⁶¹ Boston *et al*, *op cit*, p 222.

*Financial management*⁶²

The authors saw strengths in the financial management reforms as a result of coherent conceptualisation and their integration with wider management reforms within a constitutional framework. This addressed some of the criticisms of the anti-managerialists. There were technical issues of accounting policy and implementation with regard to retention of surpluses achieved through efficiency improvements and the number of output classes for parliament to appropriate funds to. There were too many output classes in some policy areas and too few in others. These issues raised constitutional questions that the accounting policies sought to resolve. The writers noted the favourable report by the auditor-general on the development of cash and debt management policy by the Treasury's Debt Management Office. The authors also pointed to some technical issues in the policy for charging for the use of capital. They noted the auditor-general's concern in 1989 over the lack of attention in legislation to reporting by ministers on their performance.

Responsibility and ethics

The authors put the case that the career public service should be regarded as a profession that took account of a range of perspectives and values and should be consulted with legitimate interests. They treated political processes not just as ways to resolve issues but as an expression of a democratic government that does not sacrifice responsibility in order to get things done. The authors quote a description of responsibility by Bob Gregory that, "a person ... may give an account of the choices made, but responsibility requires one to contemplate reasons for those choices and to live with the consequences that flow from them. In this sense, therefore, accountability may be understood as a necessary but by no means sufficient component of responsibility".⁶³

The writers were concerned over how to institutionalise ethics when the public service was undergoing great change, turnover of staff was higher and the numbers of middle managers, who could be mentors to new staff, were being reduced by flattened structures. Also, the service was seen to be distancing itself in accordance with parliament's wishes from the previous culture. The authors were also concerned that the growing organisational

⁶² Boston *et al*, *op cit*, pp 268, 270, 278, 294.

⁶³ Boston *et al*, *op cit*, p 320.

cultures of individual departments may be inconsistent with the inculcation of a single set of ethical standards across the government.

Other academic commentaries

There are many other contributions to debate about the management reforms but it is neither practical nor necessary for the purposes of this chapter to summarise them all. These have been drawn together in the major academic contributions, especially by Boston *et al.* There is, however, a stream of criticism that echoes many of the points already noted above but that comes from a more distinctive and transparent ideological or ethical base. These other writers view the reforms as a key element of a wider programme of liberal economic reform in New Zealand, which they see as a local adaptation of the so-called 'Washington Consensus'.

Usually there is acknowledgement by these commentators that the New Zealand public sector reforms are distinctive internationally, although they are regarded as flawed in theoretical conception and application. These writers see the reforms as bringing market norms into the public sector, and as eroding responsibility in the sense referred to by Schick and Boston *et al.* These other writers dislike the corporatisation of public enterprises, privatisation, the specification of performance objectives, and the provisions of the Public Finance Act 1989 and the Fiscal Responsibility Act 1994. Some of the criticism reflects similar points to those above concerning specific details of design and implementation and tendencies that might exist. At root, however, these other commentators see the reforms as anti-democratic in various senses of the word.

A typical view is that liberal economic reform has, in general, seen the reduction of the powers of the state and of politics in the economy and in society.⁶⁴ The other commentators see the state as having become more centralised and rationalised in the exercise of its powers and also reducing the scope of its activities. They dislike both. Their solution is to put more politics back into policy, extend the powers of the state and to devolve various powers to sub-national governmental and non-governmental organisations. They suggest that this solution would require a different model of public management or even a radical reconstruction. Typically these writers have faint praise for some aspects of the management system

⁶⁴ For an example, see Srikanta Chatterjee, Peter Conway, Paul Dalziel, Chris Eichbaum, Peter Harris, Bryan Philpott, Richard Shaw, *The New Politics: a Third Way for New Zealand*, Dunmore Press, Palmerston North, 1999.

and some acknowledge certain positive outcomes from within a generally very critical perspective. Key points from the contributions of four of these writers are noted below.

*Richard Shaw*⁶⁵

Shaw's critique accepts that the reforms, which he labels "the Wellington model", have delivered some positive outcomes but "have also damaged the fabric of the New Zealand public service". He focuses explicitly on what he regards as the less positive features. His starting point is that "there is no question" that the reforms were shaped by something he calls "government by the market". What he means by this is privatisation and "market concepts of competition and efficiency".

He echoes Schick's concerns in several areas. He sees restructuring of the core departments as having caused difficulties in co-ordination between policy and implementation activities. The ownership interests of these areas have been neglected due to an unbalanced focus on the purchaser interest. Shaw asserts that it is "abundantly clear" that a considerable investment is required in the ownership interest and proposes that this should be on the basis of a set proportion of a department's appropriation. There has been a relative neglect of outcomes in favour of outputs and there is the possibility of "checklist management". Like other commentators Shaw wants performance objectives shifted more towards outcomes.

He sees the reformed relationship between ministers and chief executives as providing some clarity over responsibilities and improving transparency and accountability for performance. He is concerned that the new relationship encourages an artificial concept that ministers are not involved in operational activities and senior public servants have no influence on shaping policy. Shaw quotes evidence, however, to the effect that those ministers and officials do not accept this artifice.

He acknowledges that the contracting by government with non-profit providers of social services has been beneficial in some instances but that it has also caused the providers to incur cost and uncertainty. Also, Shaw does not like the fact that the relationship between the government and these providers is not a partnership of equals but is a contract for the provision of services. He says that in health, for example, demand has in some circumstances been unmet because of a lack of resources in the provider contracts. His solution is a negotiated 'partnership' with a range of

⁶⁵ Chatterjee *et al*, *op cit*, pp 187–218.

stakeholders in which the government has less say about what services will be provided and is less concerned about what they cost. (Shaw admits that the financial issue is a 'kink' in the idea that will require ironing out.)

He is dissatisfied with the level of involvement of citizens in shaping policy on service delivery (although offering no critique of what is in fact done) and regrets the abolition of elected representatives on purchaser and provider boards in health (they have now been re-introduced).

Shaw ends with the rhetorical flourish that "it is time the dismantling of New Zealand's public service was halted ... time to rekindle the flame of public service which has burned low ... acknowledge the value of public service and the contributions of public servants".

*Brian Easton*⁶⁶

Brian Easton's perspective is that the public sector reforms were a part of a larger policy programme that he labels 'commercialisation'. He defines this as "the application of business (or commercial) principles to the public sector (or particular public sector activity)". This commercialisation includes privatisation and is based on the philosophy that 'business is always best'.⁶⁷ His critique of the management system at the core of the government is a part of a larger critique of the policy programmes of New Zealand governments going back to 1984 and, in a few respects, before that. While Easton believes that there had to be market and social liberalisation, he argues that the measures taken were more extreme than was necessary or justified.⁶⁸ He sees the continuing development of multi-party government as moderating the policy processes and being likely to produce better outcomes more in accord with the desires of the population. He thinks it likely, however, that the fiscal deficit will be larger than otherwise.

Turning to public administration, Easton amplifies Schick's critical points while overlooking his points of approval. Easton centres his critique on what he sees as the move beyond managerialism to contractualism, which he associates with responsibility and accountability respectively.⁶⁹ He asserts that the accountability of contractualism sabotages the responsibility of

⁶⁶ Brian Easton, *The Whimpering of the State*, Auckland University Press, Auckland, 1999.

⁶⁷ Brian Easton, *The Commercialisation of New Zealand*, Auckland University Press, Auckland, 1997, p 26.

⁶⁸ Easton (1999) *op cit*, p 6.

⁶⁹ Easton (1999) *op cit*, p 88.

managerialism. On this point he apparently differs from some other critics, quoted above, who see managerialism as a threat to responsibility.

At the base of Easton's critique is a dislike of the use of institutional economics, although he concludes his book with the curious recommendation that the work of one of its leading figures, Ronald Coase, offers a preferable methodology to what has gone before. In practical terms Easton is concerned that institutions have been designed in a manner that ignores or undermines professional ethics and personal responsibility. He sees this as consequent on the assumption that public servants may be self-interested, which he sees as underlying the performance management system. While not arguing that public servants are never self-interested or opportunistic, his concern is that controlling it through contractualism is "... so disdainful of the human condition, that it shifts the nation back towards a Hobbesian life ...".

Easton goes as far as to say, however, that the Public Finance Act 1989 and the State Sector Act 1988 have not been "wholly disastrous" but makes the extraordinary claim that reformers ignored, or sought to undermine, the personal responsibility and professionalism of the core public sector.

In more practical terms he notes that general employment law has undermined the original intention to subject chief executives to dismissal for poor performance. Rather than focus on that law, he prefers what he alleges was the previous system, that the SSC places people in second tier positions to cover the defects in chief executives. Easton does not consider what the effects of such a proposal might be on the morale and performance of the top management team in a department. He is, instead, concerned about the relative decline of salaries between the public and private sectors.

Easton also ends his book with a flourish. "Commercialisation has many faults, but the greatest has been its denial of creativity, of curiosity, of decency, of humanity – its denial of life."

*Jane Kelsey*⁷⁰

Jane Kelsey, who has published a number of books that are highly critical of New Zealand's economic and social policies, sees what has occurred in the public sector as an endless cycle of restructuring, job insecurity, pay squeezes and threats to privatise. She quotes from an article of mine⁷¹ that

⁷⁰ Jane Kelsey, *The New Zealand Experiment*, Auckland University Press, Auckland, 1997, (2 edn), ch 6, pp 137–149.

⁷¹ G Scott and R Blakeley, *op cit*, p 24.

distinguished between hygiene factors in public management (systems, structures, planning, finance, remuneration, information technology (IT)) and the soft factors of leadership, values, personal responsibility, empowerment, teamwork and strategic thinking. She says that the soft side never developed. She echoes Boston *et al* in being concerned about fragmentation. She is critical of the emphasis on change management skills at the top of the public service, rather than knowledge of the subject area, and she notes that the SES conditions did not attract high-calibre private sector managers as intended. She quotes former SSC chair, Mervyn Probine, as being concerned about whether fixed-term appointments meant chief executives were less inclined to give unpalatable advice.

Kelsey quotes the public sector union's complaints that the intertwining of the government's responsibilities as an employer and its fiscal targets caused nil or negative pay adjustments, de-skilling and casualisation. She believes that while the Treasury talked of quality and responsiveness, its prime interest was in controlling government spending. She is concerned about the speed of policy implementation and the use of consultants. She echoes the usual concern over attention to outcomes and policy analysis.

Kelsey acknowledges that some of the reasoning behind the restructuring was valid and that there were some increases in efficiency and accountability but she laments the absence of ongoing monitoring and evaluation of the reform programme. She joins Boston in his concern over the implications of agency and public choice theories for Westminster conventions and she is more concerned about the capture of policy by ideologies and professions than by the implementation arms of government.

*Bruce Jesson*⁷²

The late Bruce Jesson takes an openly ideological position and views the reforms to public management as part of the takeover of New Zealand by a coercive financial elite. He sees the market as being destructive of democracy, community and ethics. He asserts that the Labour political movement in New Zealand has lost the committed political constituency it once had in the unions, the public service and the professions such as teaching.⁷³ He thinks that politicians and bureaucrats will have to define an independent New Zealand interest that will require the "financial apparatus of coercion"⁷⁴ to be

⁷² Bruce Jesson, *Only Their Purpose is Mad*, Dunmore Press, Palmerston North, 1999.

⁷³ Jesson, *op cit*, p 210.

⁷⁴ Jesson, *op cit*, p 219.

removed from the public sector to allow alternative cultures to flourish – humanism, environmentalism, feminism and national identity. The problem is that the public service in his view has been colonised by the political right. The answer is to make ministers more responsible for departments, chief executives more responsible to ministers and to get rid of right-wing chief executives. I doubt that Jesson was right that the public service was once a political constituency with commitments he approved of, and is now right-wing. He might have drawn some comfort, however, from a passage in a speech by the Hon Trevor Mallard – minister of state services in the Labour/Alliance coalition:

I want to start by sharing a tale I heard very recently from a public servant.

She rang my office after a conversation she had with the office cleaning staff. When she asked one of the cleaners how they were, she received a very positive and cheerful ‘great’.

When she inquired further to find out what could possibly be causing this upbeat mood, she was told: ‘because of the new government’.

Her curiosity piqued, she inquired still further.

“Why?”

“The offices are cleaner.

“There’s not as much food left on the floor.

“The staff are friendlier – they smile and say hello.

“People aren’t in as much of a hurry.”

The cleaner’s job was taking less time than it used to.

I was really heartened by this story.

Because while I know public servants are working really hard to implement the government’s policies and this was a bit of affirmation that we’re going in the right direction. That in at least one agency people are working positively and are happy.⁷⁵

Comment from state services commissioner

Michael Wintringham, the state services commissioner, has captured the nature of many of the more strident critics of the public sector management system in the following description:

Inevitably from time to time, ministers find themselves having to run the politics that come out of some management decisions which by themselves may be

⁷⁵ Hon Trevor Mallard, “Complying with the new government’s priorities and plans for improving public sector performance and accountability”, speech 3 May, 2000.

technically unexceptional. When that happens, many people in New Zealand – commentator and editorial writers especially – are too willing to leap from isolated decisions – taken out of context – to conclude that the state sector reforms were a mistake. At its crudest, the sequence goes something like this: the manager in the public service comes to a view that it is more cost effective to contract in some specialist service rather than maintain capability in-house; a general sweep of all departments by an opposition MP under the Official Information Act seeks out all instances of expenditure by consultants in the year 1999; this finds its way into a press statement or question in parliament ... someone releases a press statement about the waste and extravagance of the uses of consultants ... talk back hosts and their insomniac guests rail against waste and extravagance in the public service; the state sector reforms were a mistake; let's all go back to the golden age of public administration ... the public debates about the big questions facing our society reach yet another plateau of irrelevance.⁷⁶

REACTIONS OF POLITICIANS TO THE REFORMS

The state sector reforms gained a high degree of bipartisan support among senior politicians. Successive governments up until 2000 have satisfied themselves that the State Sector Act 1988 and Public Finance Act 1989 are suitable cornerstones for the system of public management. Each new government makes some improvements and adaptations to the management system and officials periodically launch initiatives for improving it in some respect or other. This stimulated Allen Schick to note what he called “the spirit of reform”.

The National government, elected at the end of 1990, did not immediately embrace the reforms incorporated in the State Sector Act 1988. During the parliamentary debate on the State Sector Bill in 1988, Jim Bolger, who was then in opposition but was to become prime minister in 1990, stated categorically that it would be repealed and replaced with appropriate legislation.

The incoming minister of state services in 1990, the Rt Hon Sir William Birch, had been the leading opposition critic of the bill and proposed initially that a white paper be prepared promoting changes to the legislation. This was to include the removal of cabinet power to direct the appointment of a particular person to a chief executive position. This proposal did not

⁷⁶ Michael Wintringham, state services commissioner, “Problems in practice: capability in the state sector”, speech to the New Zealand Legal Research Foundation conference, September 2000.

proceed. Instead, the government set up a group, convened by Basil Logan, in 1991 to review the state sector reforms in general terms.

During the 1996 election campaign none of the main political parties advocated any changes to the legislation. In 1999 there was a focus on the unacceptability of certain salary levels in Crown entities, a failing IT project in the New Zealand Police Department and items of expenditure in another department that were considered unreasonable.

Senior ministers, with the background of a variety of portfolios, particularly those who have experienced the former public management system, have commented that the reformed system is superior in terms of its transparency and accountability.

Finance ministers have commented that the system has greatly enhanced the control and direction of public expenditure.

A minister of state services, the Rt Hon Simon Upton, has, on numerous occasions, spoken publicly about the improvements that the system has brought about. At the Public Sector Management Conference in 1999, he stated that:

I've been in parliament 18 years and there is no question that we have a much more transparent and accountable public sector than we had in 1981.

In 1997, the newly appointed minister of state services (later the prime minister), the Rt Hon Jenny Shipley, made an authoritative statement about what the reforms had been about and what was required to address weaknesses in public management. She sought to shift the focus of change in government management on to the social policy agenda. In her view the reforms of 1988 took a huge step toward providing some of the tools to achieve the new New Zealand. Broadly speaking, they were designed to do four things:

- they got the government out of business that could be done better elsewhere;
- they sought to make accountabilities very clear;
- they attempted to expose the real costs of goods and services; and
- they sought to create powerful incentives for all within the system to consistently make rational decisions, and to perform their duties to the highest possible standards.

To use the jargon, the outcomes were to provide a client-responsive, cost-efficient, dynamic and robust state sector.⁷⁷

⁷⁷ Rt Hon Jenny Shipley, address to Future Issues in Public Sector Management conference on 26 March, 1997 at the Plaza International Hotel published in *Future Issues In Public Management*, State Services Commission, Wellington, New Zealand, August 1997.

In referring to tools to achieve a 'new New Zealand', Mrs Shipley was echoing views expressed by the Hon Ruth Richardson who described the new system as providing her with the tools to make the changes in fiscal policy that she had sought earlier as minister of finance.⁷⁸ In assessing the performance of public institutions, Mrs Shipley said:

The best of the Crown companies, the best of the Crown entities, and the best of the public service departments must surely rank amongst the top-performing state agencies anywhere in the world ... But, inevitably in an undertaking on the scale we have initiated in New Zealand, the pattern is really quite inconsistent. We do have some organisations that have made only superficial transitions to the new world. They exhibit the external trappings of the new but one does not have to scratch deeply to discover an old bureaucracy twitching again ... but the point to be made now is that the successes illustrate quite vividly just what the capabilities of the reformed state sector model are ... and why we must renew our efforts to lift the rest of the state sector to the same high levels of performance and to look forward toward the next important phase of change and improvement ...⁷⁹

Her diagnosis of poorly performing organisations included:

... weak initial design work, lack of dynamism, leadership and fortitude in implementation, and various forms of market resistance or vested interest.

Her proposals for improvement were the following:

- The quality of policy advice had to be substantially improved. Outcomes had to be clearly defined and policy solutions found for government consideration. This was within the context of concern over policies relating to social cohesion.
- Human resources were inadequate to meet both the demands of policy analysis and effective management.
- Departments had to stop putting their territorial interests before collective interests.
- Chief executives and their senior management teams did not own and feel committed to the strategic result areas the government had set up and were not using all their skills to see that they were achieved. There was a risk that departments were becoming cautious, orthodox, formula-ridden and preoccupied only with fiscal accountability for outputs.
- Managers had to ask fundamental questions about the most effective ways to deliver outcomes in the light of the strategic result areas.

⁷⁸ Ruth Richardson, *loc cit.*

⁷⁹ Shipley, *loc cit.*

- A new breed of manager was required with the skills to manage risks from day to day.
- In terms of the personal accountability of public servants, there was a need to build on work relating to public service principles and conduct, to achieve a comprehensive culture that emphasised the highest levels of professional ability and commitment to good government.
- The Treasury should not be the only control department. The SSC should focus on monitoring departmental contributions to government strategy and identifying ownership issues or risks.

Many of these issues overlap with other critiques as noted above. However, given that these proposals came from a prime minister and former minister of state services, they provide a clear focus on the former government's areas of interest.

The minister of state services in the Labour/Alliance government spelt out his views in two speeches in 2000.⁸⁰

He said that the underlying statutory arrangements in the state sector, as they are encapsulated in the State Sector Act 1988 and the Public Finance Act 1989, are satisfactory and sufficiently flexible to be adapted for the purposes of the new government.

Only six months after being elected, this minister claimed in the speech that: "There has been a significant change of direction for the public service". This is somewhat exaggerated in the light of what had actually been announced, let alone implemented by that time, although some elements of his thinking for the future also emerged there.

Mallard's critique includes:

- the effect on public perceptions of the government of isolated instances of extravagance;
- the need for transparency and accountability to go beyond finance;
- fragmentation that Mr Mallard alleges is caused by a contractual model;
- a bias towards efficiency and financial competency over the development and delivery of services;
- loss of people and institutional knowledge;
- re-employment of redundant workers on contract.

His diagnosis overlaps in significant respects with that of the two previous ministers of state services, Rt Hon Jenny Shipley and Rt Hon Simon Upton.

⁸⁰ Hon Trevor Mallard, speeches 3 May, 2000 and 4 July, 2000.

While saying that there are no easy answers to these problems Mr Mallard points to several government initiatives:

- an agreement between the government and the Public Service Association (the main public sector union) to work together on quality issues;
- cutting back on the use of consultants;
- setting six new strategic goals for the government.

He also emphasised the need to attract graduates and train people, but there may not have been a specific initiative on this at the time of publication. He makes a curious observation that effective public services operate within the rule of law not the letter of the law.

Most significantly, Mr Mallard foreshadows what he labels “a new capability, accountability and performance process” that gives more emphasis to strategic planning and ownership interests and takes both a longer- and a shorter-term view. Ministers and chief executives are to report jointly to parliament.

REFORMS FROM AN INTERNATIONAL PERSPECTIVE

Internationally, New Zealand’s state sector reforms were seen at the time as placing the nation on the frontiers of innovation in public sector management.

Al Gore, former vice president of the United States of America, said in 1993 that the United States was “coming fourth”. At the time he meant that the United Kingdom, Australia and New Zealand were well ahead of the United States in making changes to the size and cost of government. This is not the case today because the United States has made large gains in the effectiveness of many federal government agencies. Gore had studied the New Zealand reforms and surprised the prime minister, Jim Bolger, by approaching him to talk about the reform of government management at the inauguration of South African president Nelson Mandela in 1994.

There are many similarities between New Zealand’s reforms and those in other developed countries. The director of the United States Office of Management and Budget, Alice Rivlin, illustrated this while chairing the first Organisation for Economic Cooperation and Development (OECD) ministerial level meeting on public management. Noting that “countries are responding in remarkably similar ways”, she presented the following list of common features:

- decentralisation of authority within governmental units and devolution of responsibilities to lower levels of government;
- a re-examination of what government should both do and pay for, what it should pay for but not do, and what it should neither do nor pay for;
- downsizing the public service and the privatisation and corporatisation of activities;
- consideration of more cost-effective ways of delivering services, such as contracting-out, market mechanisms, and user charges;
- customer orientation, including explicit quality standards for public services;
- benchmarking and measuring performance; and
- reforms designed to simplify regulation and reduce its costs.⁸¹

Financial management systems similar to New Zealand have since been adopted in three Australian states and the Federal government and in the United Kingdom. Singapore has adopted output-based budgeting. Malaysia has a similar system. Thailand is also assessing and beginning to implement changes to its public management system that are based on concepts similar to those used in these other countries. There are other Commonwealth countries at differing stages of development that have adapted various pieces of the public management system. The parliament of Mongolia is considering a law consolidating its public management system that is similar, in some respects, to the New Zealand system. A steady stream of politicians, officials, media representatives, academics and delegations from international organisations visit Wellington to study the New Zealand public management system. The auditor-general of Canada and the General Accounting Office of the United States have examined the system closely.

Some people who have come to New Zealand like the system and some do not. Interest waned sharply in 2000 because the critical views of new ministers were heard internationally and this cut the stream of interested officials to New Zealand to a trickle. Also other countries, for example Sweden, became more interesting as innovators in public management for governments looking for fresh ideas and successful models.

The reform of systems of government management is a world-wide activity. Elements of so-called new public management are ubiquitous, although there is great variety in the details and timing of reform

⁸¹ David Osborne and Peter Plastrik, *Banishing Bureaucracy – The Five Strategies for Reinventing Government*, Addison-Wesley Publishing Company, Reading, Massachusetts, 1997, p 8.

programmes. Only the general principles and concepts and a few techniques are internationally mobile and each country designs its reforms for its own purposes. In Asia, which is the region that I am most familiar with, reform programmes are driven by wider economic, social and political change. The impulse for public management that is more efficient, effective, accountable, transparent and devolved in those countries is based variously on the shifting of power from corporatist oligarchies, the military, dictatorial leadership, and entrenched and often corrupt bureaucracies towards legislatures and the emerging middle classes. In the United States a Democrat administration sought to raise confidence in government institutions and address a legacy of neglect by bringing to Washington management innovations that had been made at state and local levels of government.

Whether aspects of New Zealand's system, or any other advanced systems, are appropriate for developing countries is contentious and has been debated thoroughly internationally. This debate is concerned with sequencing of reform and whether countries can leapfrog some of the stages through which the advanced management systems have passed. It is far less contentious that they should be trying to build governance and management institutions that feature transparency, accountability, multi-year planning, responsiveness, quality of service, comprehensiveness in budgeting and financial reporting, and devolution of authority to subsidiary levels.

Governance and public management is ultimately about where power arises and how it is used and so deeper political forces drive systems of public management and constrain the influences of management techniques. Much of the world's population endures governments that are without a respectable view of the public interest and that are rife with patronage, corruption and incompetent, power-hungry and unresponsive bureaucracies. In almost all these countries there are a few politicians, officials, non-governmental organisations (NGOs), academics and others who try to improve things – but who mostly fail. What badly governed countries can learn from New Zealand and other countries that rank well in the quality of public management is entirely dependent on the detailed circumstances and the will of their governments. For some, the answer is nothing.

AGENDAS OF ISSUES IN PUBLIC MANAGEMENT

There have been quite distinctive shifts in the agendas for improvements in government management. Also, many agenda items have not been addressed long after they have been recognised.

The agenda in the 1980s was characterised by structural reorganisation, performance specification, and improving information for management and accountability. The emphasis was on setting clear, non-conflicting goals, on giving authority to managers and boards to get on with their businesses, and on reducing the obscurity of accountability arrangements. There was a focus on vertical lines of accountability and on choosing the correct organisational form for each government function.

The single largest feature by far was the corporatisation policy followed by privatisation. Protected and subsidised commercial functions within departments were moved into the private sector. This involved functions where competitive markets operated and ministers were not required to intervene directly in management to promote sensible public policy objectives.

In the remaining departmental and Crown entity functions, the emphasis was on establishing accountability regimes based on the State Sector Act 1988 and the Public Finance Act 1989. While some of this was crude to begin with, as a whole the sophistication of management improved quite rapidly.

As I see it, some of the elements of the critical appraisals summarised above identify poor or incomplete implementation of the 1980s models in places where they would have probably brought performance improvements against an historical background of extensive neglect of some issues. Examples of this neglect are inadequate emphasis on the ownership interests of the government, areas of weak strategic policy analysis, weak performance specification and monitoring, weak internal management and poor governance arrangements of Crown entities. A key concern has to be the inadequacies of the processes and concepts for specifying and managing performance. In these cases ministers and officials should have done more effectively what was originally intended. My impression is that ministers and officials saw the public management reform as substantially completed and it slipped down the order of priority of the government for the last half of the 1990s. The introduction of SRAs and KRAs in 1993–94 was the last substantial initiative until Simon Upton imparted new momentum to the ownership issues at the end of the decade. The issues raised by Mrs Shipley, as discussed above, were never addressed comprehensively. To my mind, when public management became a hot political issue in 1999, the cases that became the centre of attention demonstrated very little in the way of problems that had not been foreshadowed for years.

In the mid-to-late 1990s there was a noticeable shift in issues demanding attention. A second generation agenda arose that involved different policy

areas and different management methods. The new agenda re-addressed areas where the methods of the 1980s were used inappropriately, either in conceptual design or implementation. In some instances, the issues arose from inadequate analysis of complex systems due to poor strategic policy analysis, leading to poor decision making, sometimes followed by poor execution of the reform. An example is corporatisation in situations where the basic technical conditions for improved efficiency were absent. Corporatisation of hospitals and the national electricity transmission grid are examples.

This second generation agenda, which remains largely to be attended to, also involves areas where new policy and management frameworks need to be developed. Many of these issues arise in social policy. The development of innovative and relational contracts and forms of organisation in health service delivery are examples. In this area there are new approaches that involve the capitation of primary health organisations with enrolled populations and integrated 'seamless' care for target populations or chronic illness. These approaches require policies and techniques that were not generally on the 1980s agenda for public sector reform. The progress of these approaches in the 1990s has been largely piecemeal. They demand fresh thinking, more advanced technical skills and innovative management. They also demand more advanced approaches to making commitments for service and developing new relationships between the central government, other levels of government, NGOs and private organisations and citizens.

This is especially true of Maori organisations where good progress in making these commitments has been made in health, for example, but the institutions are fragile and central government remains unstable in its views and commitments regarding what relationships it is prepared to enter into.

Also on this second generation agenda is a new framework for the governance and control of Crown entities and fundamental reviews of the policies for some of these organisations. After years of talk, an initiative was begun in 1999 in this area.

This agenda must involve consideration of the opportunities for improvement that have emerged from experience with the management system itself. These include the questions of refinement in roles, responsibilities and relationships, cross-agency co-ordination, improvements in strategic thinking in ministries, and strategic coherence around the wider interests of the government.

With a new government in place since 1999 that will want to make its mark in improving the performance of public institutions, further additions

and modifications to an already substantial agenda will emerge. The previous government's Crown entity initiative may go forward, for example, employment provisions and labour relations will change to reflect Labour philosophy, and there will be a further general tilt towards the provision of services by public organisations and a squeezing out of private providers in some areas. Much of the partly neglected agenda from the 1990s will remain, however.

Agendas overlap in time so that some remaining problems could still be usefully addressed by old fashioned 1980s and early 1990s solutions. It is important to be clear in matching problems with solutions and not to get too caught up in fashion. Because some of the 1980s tools were inadequate for the problems they were addressed to in the 1990s does not mean they are inappropriate today to address 1980s type problems. Not every public service requires a complex horizontal integrated network of inter-governmental relations, Treaty of Waitangi partnerships and citizen empowerment. For example, the fact that the corporatisation of hospitals failed does not mean corporatisation is an inappropriate solution for some other problems. By the same token, it may be failing elsewhere as in broadcasting.

The actions required for cleaning up the tail-end of the first agenda are very different from the actions required for addressing the issues in the second generation agenda and an emerging third. It is important to be able to judge which is which in order to avoid repeating failed experiments or throwing the good out with the bad.⁸²

To me, the issues that feature commonly in the criticisms and positive assessments, which are summarised in this chapter, fit a fairly clear pattern. Any thorough assessment should try to address them. Some of these issues are about implementing the system as originally intended, others are about adapting it to experience and to emerging new requirements. Still others involve introducing entirely new systems and approaches where the public management system is failing or new challenges are before us. The issues in need of attention can be grouped under the following topics:

- refining and modifying roles, decision rights and relationships, including the issues of bilateral and multilateral relationships, especially between politicians and public servants;
- accountability concepts and lessons from experience;

⁸² Graham Scott, "Continuity and Change in Public Management: Second Generation Issues in Roles, Responsibilities and Relationships", in *Future Issues In Public Management*, State Services Commission, Wellington, August 1997.

- performance management structures and processes in terms of purchase, ownership and multi-agency interests;
- human resource management;
- Crown entities;
- achieving strategic coherence and implementing government-wide objectives.

This agenda is taken up in the following chapters.

To conclude, however, a word of warning is appropriate about what can be expected realistically from an assessment of a country's public management. Jonathan Boston has said it well.⁸³ His argument goes like this. Most scholarly research has been at the micro level and in a highly specific context, for example examining the impacts of performance pay and accrual accounting. There is a lack of research into the impacts of system-wide change but this research is crucial because the performance of a management system is not only the sum of the performance of its parts. The appropriate measure of the impact of the reform is its performance compared with where the system would have been if it had continued developing as it had been prior to the changes. There will always be disagreement about this counter-factual that cannot be resolved by research. The fact that the changes did not take place at a time when surrounding conditions were stable but in the midst of macroeconomic turbulence, rapid policy change and fiscal stress makes the setting of the counter-factual all the harder.

Along with this list of difficulties is the fact that long-term effects of the reforms may be quite different from short-term ones. For example, senior executives who worked for many years under the previous public service system are still holding influential positions. The final impact of the reforms on the culture of the public service may not be seen until that generation has retired. In addition to assessing whether reforms met the objectives of politicians who took the decisions to implement them, an account should be taken of unintended positive and negative side effects (but it is difficult to know what the decision makers would honestly admit in hindsight was intended or unintended). Some of their objectives were vague and it is hard to know what they intended, for instance by the term 'biculturalism' when

⁸³ Jonathan Boston, "The Challenge of Evaluating Systemic Change: The Case of Public Management Reform", paper prepared for the International Public Management Network Conference, Learning from Experiences with New Public Management, Macquarie Graduate School of Management.

applied to the public sector. In that case, practical approaches were developed by practical people working in operational areas but the guidance from the political level was often useless and sometimes worse.

It follows that no assessment can be comprehensive, complete or conclusive. Much more evaluative research is needed. My objective in the following chapters is to summarise concepts, practices and events that, to my mind, are significant and to address most, if not all, of the issues that emerge in the critiques and that I think are significant in the search for improved public sector performance.

4

ROLES AND RELATIONSHIPS; MANAGEMENT FREEDOM AND ACCOUNTABILITY

INTRODUCTION

This chapter discusses the roles, relationships, freedoms, responsibilities and accountabilities that frame the interactions between politicians and civil servants. It also considers other important relationships that define accountability. The guiding principles and some lessons of experience relating to these interactions are summarised. Several common criticisms of the emphasis on the clarification of roles and relationships between politicians and civil servants are considered. The effects of structural changes in departmental functions are also discussed.

The commonly used expression in public management, 'political masters', captures the nature of the relationships between the politician and public manager only in default. It does not capture the normal working relationship between ministers and top managers. Senior public managers have some independence and can be influential participants in government and can be held to account for their actions – often more so than the ministers whom they serve. Even when things go wrong, although ministers are formally accountable for their decisions, regardless of the advice they receive, it has become common for the spotlight to focus on the advice and management of government agencies rather than on the minister responsible for that government agency.

The day-to-day relationships between ministers and senior public servants are complex. The chief executive of a department is variously an obedient and helpful official, dutiful implementer of directions that they may not agree with, influential policy adviser, participant in the strategic thinking of the government, leader and motivator of a department that may be huge and complex, and, finally, a communicator. All these skills must be accounted for in the designing of systems that promote effectiveness in public management.

POLITICS, POLICY ADVICE AND MANAGEMENT: THE ROLES OF MINISTERS AND PUBLIC SERVANTS

The New Zealand model of public management is founded on a clear distinction between the roles of politicians and civil servants. At its heart, this model is based on the difference between politics and non-partisan administration. As Palmer and Palmer note,⁸⁴ the key element running through the *New Zealand Public Service Code of Conduct*⁸⁵ is:

... that the New Zealand public service is politically neutral – loyal to whatever government is in power at any time. This is a corollary of the doctrine of ministerial responsibility.

There are long-established conventions about the respective roles that guide the behaviour of the parties on a day-to-day basis. As the *Cabinet Office Manual* states (para 5.88):

... officials are not responsible for justifying policy, or disclosing details of how a policy evolved; that is the Minister's responsibility.

These conventions, while now written down in detail in that manual and numerous SSC publications, are, as well, so deeply embedded in the behaviour of experienced ministers and senior public servants that they are almost innate. Only the principles of these conventions can be picked up from reading the official documents. Most public servants pick up the practical details on the job from working with experienced senior executives.

While New Zealand's conventions and behaviours have some similarity with other English-speaking countries, there are significant differences, so much so that the New Zealand pattern is unique in important respects. For example, in Australia, the appointment process for senior civil servants is far more political. Perhaps because of this, the civil service stops being available to advise ministers during an election campaign. This is not the case in New Zealand where officials continue to advise ministers right up to the election. There are, however, elaborate and well-established protocols to ensure that officials remain untainted by partisan politics. The Treasury, for example, has long-established guidelines for responding to requests from ministers to

⁸⁴ Geoffrey Palmer and Matthew Palmer, *Bridled Power, New Zealand Government Under MMP*, Oxford University Press, Auckland, 1997, p 85.

⁸⁵ State Services Commission, *New Zealand Public Service Code of Conduct*, Wellington, 1995.

estimate the costs of policy proposals in the months before elections. In Australian states, senior civil servants serve at the pleasure of ministers or premiers and turnover of staff is common on a change of government. In the United Kingdom, senior civil servants, although not appointed by an overt political process, can become identified with the government they serve to the point where they are discreetly moved along when the government changes. This was true in the early Thatcher years and the current UK Labour government has made some changes of this nature to the ranks of the senior appointments.

In the United States federal government, there is the extensive use of political appointees down through several layers of senior positions. From Canada through Asia to Singapore, the term 'deputy minister' is used to describe the heads of government departments who are political appointees in varying degrees and who have greater powers than those that New Zealand has traditionally accorded to its senior civil servants. In Canada, for example, the deputy minister in charge of the finance ministry is appointed by the prime minister and attends cabinet meetings.

The flavour of this approach can be seen in many Asian countries where government departments are accorded a role in the process of the development and implementation of strategy and are also given a leading role in the economy. In Singapore, government departments are free to shift resources between appropriated programmes without limit. In some countries in Asia, top civil servants commonly enjoy a very secure tenure, as well as being more political than their New Zealand counterparts. These countries have typically had stable political regimes for many years.

There is growing dissatisfaction, however, in many countries in Asia with the performance of their governments' traditional approaches to public management. Many governments have introduced aspects of performance management, and are loosening some of the central controls on managers. Malaysia, Singapore and Hong Kong have advanced management systems by world standards and there are other countries that do not have the legacy of British colonial administration, including Thailand, that are following suit. These management systems all increase the clarity of the roles of politicians and professional managers.

In New Zealand, there is a strong commitment to a politically neutral senior civil service, which is routinely expected to work with a sequence of ministers who are political opponents. There is a pattern of pressure on this convention that follows a change of government but that usually settles down after a few months. As I recall, the newly elected government in 1999

was more vigorous in its attacks on the civil service than any other newly elected governments over many years.

For the core civil service it is vital to establish clear rules and conventions relating to the role and function of departments and their managers. The concept of being non-political entails the civil servant not being involved in party politics and in preserving studied neutrality in respect of the power struggles and rivalries of the politicians of the day.

The litmus test of a non-political public service is whether the political rivals of today's ministers have confidence in the civil service to serve them effectively in the future, even though the civil service is working diligently for these opponents today. From my observations, mature opposition politicians do not admire senior civil servants who are seen to be ducking and weaving to position themselves favourably with them. These politicians assume wisely that the behaviour that they see in opposition is likely to be the behaviour they will see when in government. I can recall one government department that leaked information and was mistrusted by politicians on both sides of the house. Generally, civil servants accumulate the best reputations over time if they steer a steady course in respect of their policy analysis and management plans, although diligently serving the government of the day. By contrast, behaviour such as panicked rewriting of post-election briefings by senior civil servants after the election is held, earns the derision it deserves.

There have been occasions when opposition politicians have threatened to sack senior civil servants if they get elected.⁸⁶ But I am not aware of any situation where a chief executive has been sacked precipitously simply because a new minister disapproved of the individual. There have been cases of discrete early retirement and movements to other jobs under a certain amount of pressure. The five-year contract term was chosen to ensure that a chief executive worked across at least one election and, on a change of government, would work for the new government for a period before facing a contract renewal or termination. This helps to reinforce the non-political professional and managerial culture of the public service.

While political neutrality can prevail in the core government service, this is not necessarily the situation for Crown entities and SOEs. Ministers

⁸⁶ See, for example, Hon Michael Cullen's comments regarding several chief executives reported in the *National Business Review*, 15 October, 1999, p 15, "Cullen threatens top civil servants". Similar, though less personal, threats were made by National Party leaders before the 1990 election.

appoint the boards and can be influenced by their political or ideological preferences in dismissing and appointing board members. While boards may wear political livery, chief executives serving them are not expected to do so. However, there are no formal requirements relating to this.

The purpose of the purchase agreement in New Zealand public management is to establish clearly the role and responsibility of the chief executive for delivery of the services for which funds are provided. The minister, within cabinet collective responsibility, is the 'purchaser' of the outputs in the purchase agreement. In addition to purchase agreements, the performance agreements between chief executives and their 'responsible ministers' set out the expectations for meeting strategic objectives and managing effectively. The minister is formally responsible for having specified the contents of the performance agreements, whatever the process by which it is developed.

The government's objectives are part of the relationship between politicians and voters through the electoral process. The objectives are the direct accountabilities of politicians and are the indirect accountabilities of non-political government departments. The specification of performance for the departments gives this a sense of being a 'constitutional' convention. Using outputs within performance agreements can ensure clarity of what has been specified between the minister and the chief executive and provides the link to the financial control of the executive by parliament.

The SSC expresses the respective roles of ministers and chief executives as follows:⁸⁷

The State Sector Act envisages that ministers will not normally involve themselves in the day-to-day management of their departments. The general relationship between minister and chief executive should be characterised as:

- departments being extensions of the minister acting in the minister's name and in accordance with the minister's wishes and direction;
- chief executives under the Public Finance Act 1989 having delegated authority to enable the production of contracted outputs in the most efficient and effective manner and being accountable for the exercise of this authority.

In countries with a more political role for senior advisers and administrators, these detailed conventions of separation between politics and public administration are downplayed. In the United States the top policy advisers

⁸⁷ State Services Commission, "The Public Service and Government", in *Public Service Principles, Convention and Practice – Guidance Material*, Wellington, 1995, pp 4–5.

in Washington have long ago adapted to the reality that policy advisers who refuse to incorporate political matters into their advice do not last long.

There has been academic support for this reality. Charles Lindblom⁸⁸ in his famous article *The Science of Muddling Through*, pointed out that governments could rarely set clear goals that would then lead to the systematic examination of alternative courses of action. Values and ultimate goals – outcomes in New Zealand terms – revealed themselves in the process of muddling. Charles Schultze, once director of the Bureau of the Budget, saw politics and values permeating the whole decision-making process. From this perspective, policy analysts can be seen as advocates for their own points of view within the political process. Further, as the competing professional policy disciplines endeavour to push their way of thinking into new areas, there is a form of ideological advocacy in arguments over what is the best way to develop ideas about policy issues. Some ideas are, however, more useful and respectable than others.

Professionally robust advice is rooted in a discipline or methods of analysis that reflect an underlying point of view. The ministries that try to advise without first establishing some principles and disciplines in the way they think always, in my experience, leave faint footprints and usually preside over a mess that others have to fix at some point. A politically appointed public service, in the sense that governments stack the key advisory positions with people who have congenial points of view, is likely to be very weak because of inadequacies in the recruitment, development and retention of senior professional and managerial skills. Rather than trying to politicise the advice that they receive from their official advisers, most experienced ministers have preferred a contest of advice within and beyond the government. It is typically inexperienced new ministers and zealous advisers in their offices who try to pressure the key public service advisers to serve up what they want to hear regardless of the quality. Since the introduction of MMP in 1996, coalition governments have had some ministers who have objected to being given advice that runs counter to their party policy. The requirement to provide 'free and frank advice' was removed from the chief executives' performance agreements. It is not clear why this was done but there is a worry that it may result in some serious policy and implementation problems for governments.

⁸⁸ Charles Lindblom, "The Science of Muddling Through", *Public Administration Review*, Spring, 1959, pp 79–88.

It is impossible to reduce every aspect of a minister's requirements to the terms of a formal written agreement, as the then opposition finance spokesperson Hon Michael Cullen noted (1992).⁸⁹ A strong culture in the public service is essential and much will depend, as it always has, on the maintenance of a relationship of mutual trust and respect between the chief executives of departments and their ministers. A well-designed system of managerial accountabilities can complement such a relationship, but is not an adequate substitute for it.

New Zealand enjoys a core public service that is as free of political bias as any in the world. It must stay this way. The SSC is charged with ensuring this and should be more forthright when ministers step over the line and there are politically motivated attacks on the public service. Any organisation has the potential to embed in itself particular professional viewpoints, processes, values and culture. Indeed, they are expected to do this. The risks this presents to responsiveness and accountability to the political processes can be dealt with through the systems of appointment, performance management, policy making and contestability of ideas and functions. The reformed management systems allow for all of these processes.

Over the past decade or more, there has been a growth in the number of overtly political appointments of advisers in ministers' offices. In theory these appointments can provide a desirable way for ministers to receive advice from their own political or ideological perspective while keeping the public servants politically neutral. This change has worked in practice in many cases, although there are also examples of these types of political appointment causing major malfunction in the relationship between ministers and their departmental heads. In one case the chief executive of a department was sidelined from advising the minister by a political adviser.

ROLES, RESPONSIBILITIES AND ACCOUNTABILITIES

Analysis and experience have shown that clarity in the public sector management framework is critical to the performance of chief executives. The public sector reforms have been characterised by a detailed and continuing effort to clarify the elements of this management framework. The early analytical work within the government on improving systems

⁸⁹ Hon Michael Cullen, "Political Expectations of Public Sector Performance", paper delivered to 1992 Public Sector convention, New Zealand Society of Accountants, Victoria University of Wellington, 1992.

emphasised the clarification of roles and relationships, better information and more highly tuned accountability arrangements. These views arose from experiences such as the Maniototo irrigation scheme, which is described below. Schick, incidentally, calls the evidence of difficulties with roles, relationships and accountabilities “slim – an incident here and there”,⁹⁰ although he does not say what they were. In fact, in the case of the Maniototo scheme, the inquiry exposed weaknesses that were inherent in the whole system of public sector management, and not just the Ministry of Works and Development in relation to this one project.

Why is there such an emphasis on these issues of roles, responsibilities, accountabilities and structures? There is evidence that the effectiveness of public organisations is considerably influenced by the definition and quality of the relationships between staff and the people they are accountable to, and with whom they transact in various ways. The primary relationship, in this regard, exists between senior staff and their ministers.

Experience shows that poor performance is commonly associated with confusion about delegations and accountabilities. In practical management situations, effectiveness requires close attention to establishing who is accountable for what and to designing the delegations to achieve specified goals with matching accountabilities. Experienced managers simply do not question the importance of getting this right even though there are many other dimensions to effective management. A few examples illustrate the point.

The Treasury

In the late 1980s the Treasury included in a list of factors critical to its effectiveness, the clarification of its role in relation to other parties. This addition was a reflection of the Muldoon years in which the Treasury was undermined by confusion of roles as a ‘control department’. As an illustration, senior officials were on the boards of state corporations such as Petrocorp, Air New Zealand and the Development Finance Corporation. While ‘Chinese walls’ were generally maintained within the Treasury, there were tensions between officers acting in the interests of the corporations and those seeking to investigate their financial and other affairs. This undermined the department’s ability to discharge its primary function, which is to advise the government on economic, fiscal and financial policy.

⁹⁰ Schick, *op cit*, p 38.

The secretary to the Treasury was the chairperson of the board of the National Provident Fund *ex officio*. This huge financial institution controlled the pension funds of the employees of all local governments and some statutory corporations in New Zealand. When the government privatised the Development Finance Corporation in 1988, the National Provident Fund bid for the Development Finance Corporation. As Treasury secretary at that time, I had to exclude myself entirely both from the board's consideration of the purchase of the corporation and from the government's management of the sale, because of the conflict of interest. This complicated the difficulties that arose when the corporation subsequently went bankrupt and creditors made claims on the government as its former owner.

Health

In 1996, a major effort was made by the Ministry of Health to redefine the respective roles of itself, the minister of health and the boards and management of the Regional Health Authorities. This followed from a consultant's report that said that weaknesses in relationships between these key parties were seriously undermining the performance of the health system.

There were numerous accountability documents for the health authorities that were often not internally consistent. These documents amounted collectively to a control regime that was, in parts, vague or excessively detailed. They reflected an overall management framework that was lacking in coherence, with perverse incentives for managers and boards.

In 1997, the Transitional Health Authority was formed to amalgamate the four regional health authorities and, in 1998, became the Health Funding Authority. The HFA was so concerned about the effects on performance of the confused relationships that it worked with the government to design a whole new accountability and management system. The intention was to clarify responsibilities and accountabilities between the authorities, ministers and their departmental representatives. This system is described in chapter ten and is very similar to the system that has more recently been adopted as the standard for Crown entities.

Lands and Survey

In 1996, the Department of Survey and Land Information was divided into a state-owned enterprise and a department. There was debate over whether the access to the registry of titles to land should be passed to the SOE as the basis for a commercial business. It was resolved that the information

belonged to the Crown and that the SOE would have to compete with the private sector in due course for access to the information on commercial terms. This arrangement appears to be working well, although the SOE has subsequently become insolvent for unrelated reasons. Had the SOE been given the control of a public asset it would have had a monopoly. It would have been free from the constraints of market competition, giving it weak incentives for efficiency.

Justice Department registries

By contrast, an earlier attempt by the Department of Justice to become more commercial foundered when it tried to enter into a partnership with the private sector to commercialise the registries of births, deaths and marriages. This was due to a lack of clarity about the boundary between public functions and commercial enterprise. The departmental staff seemed to want to stay involved in the management of the value-added business activities based on the registry data, when there was no policy reason for the government to be involved in this. The department could have extracted the value of its database through simpler arrangements such as royalties. This could have dealt with the 'oil and water' mix of public and private sector cultures that invariably arise when departments engage in commercial risk-taking. The level of mutual confidence between the parties, which was necessary for success, was not attained. This incident and others like it are a cause for sober reflection on so-called 'partnerships' between the government and business in commercial enterprises.

Maniototo irrigation scheme

In the early 1980s the Ministry of Works and Development suffered a cost overrun of some 40 million dollars on an irrigation scheme in the Maniototo. This incident, which was one of the catalysts for public sector reform, showed up systemic failures in the management system rooted in a lack of clarity about roles, responsibilities and accountabilities. The inquiry that followed showed that, of the several parties involved, none had sufficient control and information to be held to account. In other words too many cooks were spoiling the broth and no one was accountable for poisoning the customers.

A deputy commissioner of state services at the time, Peter Boag, told me that he saw the solution to the problems as creating a system that 'caused a red light to go off in head office when a project is overrunning'. That would have been a start, but with the underlying management information systems

at the time, the light would have come on too late, not at all, or for the wrong reason. What was required was a fundamental redesign of the systems of management delegation and financial management that reallocated roles, responsibilities and accountabilities to people in the best position to ensure that projects were effectively managed.

THE EFFECTS OF RESTRUCTURING ON ROLES AND RESPONSIBILITIES

The term 'restructuring' was, for most of the period since 1984, almost synonymous with public sector reform because most public organisations went through some form of structural change. Whole departments, or parts of them, were turned into state-owned enterprises or Crown entities. What remained in the departmental form was typically broken up or reorganised internally, sometimes two or three times over the course of a decade.

The 1980s were the heyday of restructuring government organisations. It was not so much a novelty in itself because 'machinery of government' exercises had always been conducted by the SSC in accordance with general principles. On some previous occasions structural changes were made on entirely pragmatic grounds. This included the fundamental restructuring of a department in order to solve problems in the performance of its management tenure system for top management.

An example of this fundamental restructuring was the creation, in the late 1970s, of the Ministry of Energy that brought together almost all the government's interests in energy resources and production. A large sector of the New Zealand economy was reorganised into a shapeless conglomerate of competing departmental empires, purely to solve problems in personnel and co-ordination in the head offices. The arrangement had no other rationale. Within a few years the department was disassembled and finally corporatised into SOEs, some of which have since been privatised. Such lessons from the past should not be forgotten today in the government's consideration of the clustering and merging of portfolios. Central agencies should develop clear principles, based on theory and long experience, for structural separation and the merger of activities.

A recurrent pattern appeared in the restructuring after 1984, which differentiated it from what had gone before. It was based on different principles, which can be summarised as:

- separation of ownership and purchase responsibilities;
- separation of policy from operations;

- separation of funding, purchasing and provision of services;
- competition between service providers; and
- reallocation of functions for focus, synergy and information.

These structural measures were seen as contributing to efficiency and effectiveness by modifying decision rights, information flows and incentives to improve the alignment of the goals of organisations with the goals of the government. It was accompanied by an unparalleled decentralisation of authority to managers. An aim was to avoid many of the goal conflicts that had been seen to undermine performance in the public sector. These measures exposed information flows about priorities, cross-subsidies, strategic and operational goals and information for accountability purposes. They were also intended to diminish the risk of capture of resources and policies by service provider organisations or powerful and articulate pressure groups. Further, these measures were intended to permit the development of strong management cultures and ethics in support of organisational missions. This structural focus was not possible in the conglomerate organisations that were undertaking disparate or even competing functions.⁹¹

The era of wholesale restructuring, according to the principles summarised above has evolved on the basis of experience and the arrival of new challenges in public management. In addition to seeing the benefits of restructuring, we have also learned much about its limits and costs.

Not all the large operational functions have departed from the core of government. Some remain as departments, such as the various components of social welfare service delivery and inland revenue. These are principally delivery functions associated with the following of laws and regulations. Parliament is not looking for much discretion to be exercised; rather what is required is a non-political administration of functions with high levels of accountability. Where it is intended to allocate greater discretion, the tendency has been to create Crown entities, although there are some exceptions to this.

Has restructuring fragmented the public service?

Restructuring has resulted in a large number of small, focused ministries and departments. This has led to some argument about whether the benefits of

⁹¹ Detailed discussion of these structural reforms can be found in any of the publications reviewing the reforms and cited in the footnotes to this chapter and chapter two.

focus have a cost (caused by fragmentation), in contrast with a model in which these functions were grouped into larger conglomerates. There is no systematic overall evidence to suggest that small organisations inherently fail to perform. There is, however, a fairly widely held view that small ministries have difficulty in achieving a critical mass of highly skilled human resources to carry the weight that is expected of them in policy advice and debate. These small ministries may not be attractive to competent, ambitious ministers.

The fact, however, that there are large public organisations about which the same criticism can be made suggests there is no clear conclusion on whether small ministries should be merged or not. The restructuring has created a considerable number of top executive jobs running relatively small, focused units, and the continuing discomfort over this alone is cause for careful reconsideration. One cost to account for is the multiplication of ministries that are to be consulted in the preparation of policy advice. The answer is not likely to be a blanket conclusion that small ministries are good or bad. Size is only one factor affecting performance and not necessarily a significant one.

Some restructuring initiatives have sought to gain the benefits of decentralisation with focused units, while ensuring co-ordination through contractual and managerial relationships between the autonomous organisations. The restructuring of the Ministry of Justice sought to establish such a relationship between the ministry and the Department of Corrections. The Department of Social Welfare was divided instead into internal subsidiary organisations until 1998. The Department of Labour advised for many years against the separation of the employment service and sought synergies between it and the department's other functions. The 1998 merger between the Department of Labour's employment service and the Department of Social Welfare's income support service saw another set of synergies as more important. A policy ministry, the Ministry of Social Policy, was created at the same time. Time will tell whether this will work. The organisation that resulted, the Department of Work and Income New Zealand, has had a difficult beginning according to the review by the former state services commissioner.⁹² One criticism of the department is that it is very weak in policy skills. Even with the main responsibilities for policy located in a policy ministry, the department should still have the capability for planning and analysis of operational policy.

⁹² Ministerial Review into the Department of Work and Income, Wellington, May 2000.

Some of the critics of this merger attribute certain weaknesses in co-ordination and co-operation to the disassembly of conglomerate departments and the arm's-length relationships between organisations. The critics do not, however, present evidence that conglomerates work better. Experience shows that it is not easy to co-ordinate the disparate functions within a conglomerate government department. For example, the Department of Internal Affairs has always contained functions with little in common, although in recent years management has created coherence around a theme of national identity. The components of the former Justice Department did not operate as a unified whole. The same applied to the Ministry of Works and Development and to the Treasury before it dropped its non-core operational functions in the 1980s.

Typically what occurs in conglomerate departments is that a senior manager in charge of a semi-autonomous unit inside a conglomerate becomes quite independent of the wider departmental management systems and culture and sees them as an irritating constraint on the unit's ability to perform. Such units can become a place to park senior staff who are not going to make the grade to the top management of the wider department – which can contribute to a defensive and inward-looking culture. Top managers often neglect these 'backwaters'. The performance of individual operating units without synergy with other units in a department is best enhanced by providing extensive delegations to managers, and by installing a performance management framework that is transparent to external scrutiny.

Small agencies were designed in part to offset problems of non-transparency and provider capture of policy inside conglomerate organisations. These are still powerful arguments. Explicit measures to embed general requirements for concern for the wider interests of government and the public, or specific requirements to work jointly with other organisations, can be added to the argument. It would, however, be just a new form of provider capture to leave a proliferation of small agencies in place simply because the ministers and top managers concerned did not much like the idea of being re-attached to some larger units. Issues of critical mass of highly skilled staff and co-ordination of units can support re-attachment in particular circumstances.

Making explicit arrangements for co-operative and co-ordinated activity among separate units inside conglomerates requires more forceful action by the centre of government than is evident in some areas. This action involves establishing lines of accountability, decision rights and processes in ways that align the incentives and powers of decision makers with the

government's strategic directions. For example, groups of managerially autonomous operating units that have a contribution to make to a high priority strategic goal should be accountable to the same top-level decision makers, be they ministers, boards or chief executives of central ministries.

The focus by ministers on the clarification of performance agreements for chief executives can readily be used to facilitate the co-ordinated purchasing or funding of outputs from separate agencies to meet overarching goals. This clarification is likely to be most effective when control of the budgets and strategic plans across the constituent organisations lie with a minister or an agency that is accountable to government for the overarching goals. Placing joint responsibility for work that requires co-operative approaches between departments also promotes integration of service delivery, but it must still be clear what should be achieved and who will be accountable. These techniques are elaborated in chapters seven and 11.

The nature of many of the policy challenges that New Zealand's public sector faces in the coming years will require extensive interaction between agencies. An example is the government's policy on 'family start', which involves the co-ordination of major social service providers involved in supporting families at risk. Another example of co-ordination of departments was the management by the Ministry of Commerce of the 'bright futures' initiative to stimulate the development of intellectual capital. This project involved co-ordinating the work of many government departments that reported through to a committee of nine ministers. Effective processes for co-ordinating thinking and action in such areas are indispensable.

There is one vitally important, even if obvious, point to be made with regard to the implications of this type of co-ordination of departments for the roles and responsibilities of the parties. No matter how complex the processes by which it is decided what a chief executive will be accountable for, the effective achievement of results requires a clear expression of what those results are and whose job it is to produce them. One of the strengths of the new management system over the previous system is that this accountability is possible. The traditional interdepartmental committees of years gone by were not as clear in this regard. It was not uncommon for them to reach compromises that none of the participants took ownership of, or felt strongly committed to. A department directed to do something it disagreed with could, more easily than today, compromise the implementation of decisions because clear requirements were not established.

The organisational answer to the challenges of complex cross-cutting issues, such as policies for strengthening families, is to have a superior

strategic planning process that draws in the necessary contributors. The answer is also to have decentralised management options that empower staff at lower levels to act to implement clear goals. The new challenges require the previous agenda of management reform to be completed and embedded so that departmental managers can think and plan together but act alone on delegated authority. The embedding of the performance management system will promote the handling of cross-cutting issues rather than the reverse, as might be implied by the criticism on the subject of the collective interests of government as discussed above. A poorly managed, hierarchical department will generally be unable to co-operate effectively with other departments other than on issues that are managed directly by top executives. Integrated social services, for example, cannot be delivered effectively to citizens in this way. When several agencies are dealing with the circumstances of a family or community, the front-line staff must have the discretion to make decisions within a clear managerial framework.

Dynamic influences on structure – do today's challenges need new structures?

Discussions of structure within departments are conventionally couched in static terms and the principles of the restructuring of the departments, as described above, can be seen in these terms. In reality, departmental structures are not enduring and governments adjust the structures over time in response to changing strategic priorities and management processes.

Experience in New Zealand, Australia and elsewhere shows that the restructuring of government activities around the principles of separating funding, owning, purchasing and provision includes both success and failure. The structural models that were designed were successful in terms of the objectives set for them when applied to departments that were engaged in the production of simple private goods such as telephone and postal services. They have not been nearly so successful in areas where the government retains a strong interest both in the ownership of service provider organisations and in an agency role on behalf of consumers. There may not be superior alternatives for management in such circumstances, but the search should continue or the policies should be changed so that the associated public institutions are more manageable. There can only be heartache from policies that create unmanageable institutions but that place the blame for the policy failures on the people directing or managing them.

Systematic work is needed to sum up these experiences and to draw up more refined principles and conditions for future public management

initiatives. The old 'machinery of government' tool kit needs reworking to keep it on the leading edge of public management analysis and methods. Some tools may simply have no further use at all and most will be in need of refinement and modification. The underlying theme should be the search for forward-looking performance improvement by examining the effects of structural changes on roles, accountabilities, incentives and information.

Strategic management at the centre

Case studies from the business management literature show that the benefits of decentralisation of management control need to be counterbalanced with a capacity for strategic action at the centre of an organisation. The need for this balance is not constant over time and a corporation may need to strengthen central control at times when it faces a major strategic threat or opportunity. The same applies in the public sector, which can be seen to centralise control at times of great challenge.

An interesting example is provided by the government of the state of Victoria, Australia. In the early 1990s, Premier Kennett implemented within a few years a far-reaching programme of reform in a highly centralised form of administration. At the premier's initiative, 23 departments were amalgamated into eight. The premier appointed the departmental heads himself. The span of control of these heads is immense. One department is a merger of five former social service departments and employs 12,000 staff. The eight heads have between them 50 to 60 direct reports. Under Kennett, the group of executives worked closely together and were very tight-knit around a strong corporate perspective. They agreed on objectives and debated only the means to achieve them. Together, with two central agency officials, the eight heads formed the State Co-ordination and Management Committee that operated as a board of advice and management. It engaged regularly in close discussions with the premier about strategy, policy, personnel and management issues. The premier conducted the assessment of the performance of the department heads and awarded bonuses to them. He also reviewed the performance of the ministers.

This degree of centralisation was likely to be excessive in the longer term. It led, however, to a rapid and extensive programme of change that pulled the state back from financial crisis. There is clearly a useful message about making structural change, even temporarily, in order to concentrate authority in the pursuit of pressing strategic goals. The State Co-ordination and Management Committee implemented vigorously and successfully a collection of policies that were conceptually clear and familiar inter-nationally.

The government of South Australia has similarly amalgamated its departments and agencies into larger conglomerates. The Department of Health and Human Services combines health, housing and family support and aims to co-ordinate the delivery of services across these sectors.

Considering that the state governments in Victoria and South Australia, and in other jurisdictions around the world, have taken the view that consolidation of small agencies has some advantages in terms of strategic capability, at least temporarily, there are grounds for giving this issue some serious consideration. My view, as noted above, is that we should aim to get the best of both worlds by centralising only those matters for which the centre of government has natural advantages or necessary functions to perform.

The question of minimum size for organisations to get critical mass, especially in the accumulation and management of human capital, has been under-emphasised and needs attention.

BICULTURALISM AND THE TREATY OF WAITANGI

The policies of successive governments over many years have been quite unstable with regard to how the Crown and its constituent organisations will relate to tribal authorities and non-tribal Maori organisations.

Within the government there has been a constant switching backwards and forwards between mainstreaming Maori policy and service delivery and the creation of special-purpose organisations to serve Maori. From the point of view of the tribal authorities, there has always been a degree of concern about whether a public organisation truly represents the Crown or whether that role can only be undertaken by a minister.

Some of this uncertainty is inevitable given the unclear status of the Treaty of Waitangi in law and public policy and also the detailed questions as to whether article two or article three of the Treaty of Waitangi is applying in particular cases. Also, the basis for engagement between the organs of government and Maori authorities is to be found in several Acts of parliament that make no specific reference to the Treaty of Waitangi.⁹³

⁹³ The position of the Treaty of Waitangi and other laws is succinctly described by Professor Mason Durie in the paper "A framework for considering constitutional change and the position of Maori in Aotearoa" that was presented to the Building the Constitution conference, Wellington, 7–8 April, 2000.

A degree of uncertainty is inevitably going to persist in these bicultural relationships as the law and policy evolve over the years. It seems to me, however, that some of the uncertainty about these relationships is avoidable and could be usefully clarified by policy or court decisions that establish more securely the basis of agreements between government agencies and tribal authorities and non-tribal authorities where these relationships are entered into. A barrier to securing this clarification has been the unwillingness of government to confront potentially divisive matters for the public and politicians.

A case in point is the agreements that the HFA entered into with tribal authorities that established a framework for the planning, consultation, funding and monitoring of health services provided by the HFA for Maori. From the time of the forming of the Regional Health Authorities through to the end of the mandate of the HFA, these framework arrangements developed around the country. Whether these agreements were a reflection of the Treaty of Waitangi requirements, or just general public policy, or a requirement under the Health and Disability Services Act 1993 to take account of the special needs of Maori, can be debated.

A consequence of this lack of clear direction was that various institutions, in the health area in particular, filled the vacuum and went beyond actual government policy decisions. These administrative decisions effectively set precedents where there should have been policies. This has left needless uncertainty. For example, it is not clear how these health service arrangements for Maori will be treated under the health policies of the government that was elected in 1999. This government, when in opposition, was strongly opposed to them. It saw the policies as a fragmentation of the national health system but I think that these health service agreements for Maori will be repackaged and retained. It would be a step forward to establish a policy and legal framework in which such agreements with Maori could be developed.

SUMMARY AND CONCLUSIONS

Roles and relationships may be complicated, but we need to learn well the lessons of experience that performance is at risk if roles and relationships are not clear.

Unless great importance is put on defining and embedding managers' freedoms and accountabilities, the management framework will degrade into ill-considered ad hoc interference in management, with a loss of performance across the system. To motivate and empower managers to

achieve excellence in managing their departments, they must have deep delegations of authority. They must accept detailed accountabilities for the use of that authority. By allowing a blurring of accountabilities, ministers would quickly cause the public management system to decay back to bureaucratic centralism. This has already been happening in part because the public will not tolerate a public management system in which accountability by chief executives for poor performance is fudged.

New Zealand is too small to have a government in waiting. Experienced professional managers and policy advisers are necessary to maintain and extend the capability of public organisations. The government needs other ways to deal with organisational biases towards particular professional viewpoints, values and culture. The risks that biases present to responsiveness and accountability to the political processes can be dealt with through the systems of appointment, performance management, policy making and contestability of ideas and functions. The management systems allow for all of these. A non-political public service is important to the maintenance of public confidence.

Structural reform over many years has reflected principles that were intended to clarify relationships, remove conflicting interests and promote efficiency and responsiveness to ministers and citizens. The changes have greatly and positively influenced the scope of chief executive positions and the requirements on them for management and technical skills. The management structures need continual adaptation to changing circumstances in order to maintain effectiveness. The structures today could be better adapted to promoting strategic coherence and to integrating related portfolios.

There have been weaknesses in strategic and operational coherence across some segments of the government where complex integrated problems have arisen. Looking to the future, the major challenges that governments will face are more likely than in the past to be in areas where complexity and cross-cutting issues require integrated responses.

The performance management system is capable of promoting co-operative behaviour, cross-departmental service delivery and strategic thinking, particularly if ministers want this. More generally, the methods for reforming the machinery of government need updating to account for the relationships between structure, roles and performance as discussed in this chapter.

ENHANCING THE ROLE AND CONTRIBUTION OF MINISTERS

INTRODUCTION

This chapter discusses the roles of ministers in relation to the performance management system and their cabinet responsibilities. It also considers the roles of the central agencies in assisting ministers to carry out their cabinet responsibilities and the use of advisory boards to help them do this.

The whole system of government management relies on ministers carrying out their individual and collective cabinet roles with a considerable measure of competence. Some ministers have been remarkably able in using the system to drive the government organisations under their control to change priorities and to achieve continuous improvement. They do this by close involvement in the strategic planning of the department, in the detailed attention to the contents of the chief executive's performance agreement and the budgeting behind it, in careful and balanced formal reviews of performance, and in periodic informal discussions with the chief executive and other senior staff about performance. Ministers also have the opportunity to build and maintain effective relationships with the department's management team and to provide leadership and motivation.

Not all ministers have these capabilities. Some are very ineffective. At worst there have been a few ministers who lacked even an elementary understanding of what is appropriate and necessary for an effective relationship between a minister and chief executive. Formally, a minister is accountable for the directions given to a department as to the services it is to deliver and the policy directions it is to follow. A minister who is ineffective in this is likely to accept uncritically the proposals from their department, fail to ensure the implementation of the government's policies, and disrupt the quality of policy advice, departmental management and service delivery. In the worst cases, this is sufficient to cripple the performance of a department.

Another pathology that is all too common is the minister who prefers to have a weak and compliant department rather than one that questions and tests ministerial initiatives that it thinks are flawed. This compliance can go as far as ministers telling officials, who are paid by the taxpayer to provide advice to ministers, not to question and test proposed initiatives. Weak departmental officials have, on too many occasions, gone along with this.

Skill in the administration of a ministerial portfolio is only one possible reason why a politician might be selected for a cabinet post. Often, however, more significant influences are at work. Factions within caucus may have to be balanced, and the advent of MMP has seen the quota of cabinet positions for minor parties resulting in ministers being appointed with no experience of parliament, let alone executive government. MMP has, on the other hand, aided the retention of senior ministers in marginal electorates through their presence high up on the party lists. In allocating cabinet positions, prime ministers consider rewarding loyal supporters and weakening rivals as well as appointing the best people for the job. Assembling a cabinet is about politics, yet the administrative and strategic capability of any government will ultimately decide its fate. The skills of ministers in this regard are a decisive influence on the quality of public management.

ROLE OF THE PRIME MINISTER

The prime minister has a critical role in managing ministers individually, and managing the structures and processes used to carry out the business of the government, particularly the cabinet.

Management of ministers

Prime ministers have only very restricted choices as to who is in the cabinet. They typically have to work with some weak performers who are not removed unless their performance is demonstrably damaging to the government. Traditionally, cabinets are drawn from members of parliament and the question of whether all members of cabinet must be drawn from parliament has not received much attention, although Sir Frank Holmes has suggested that this convention might be modified. If the republican debate develops to a point where new constitutional arrangements are being considered, then a change in the nature of the cabinet might be an innovation worth examining under some scenarios for the executive of the government. The advent of list members of parliament (MPs) can be seen as a step in this direction. These are, in effect, *de facto* political appointees and more could be chosen for their potential contribution to cabinet rather than their skills in representing constituents. In 1999, the Labour Party placed law professor and former party president, Margaret Wilson, on the party list with the intention of giving her a ministerial portfolio after the election. She also ran as a constituency MP.

Prime ministers can assess the performance of ministers on two dimensions. The first is their management of the political aspects of their

portfolios. The second is their work in setting performance objectives for their agencies and in attending to the ownership interests in the agencies for which they are designated as the responsible minister. The delivery of agencies on their performance agreements and other accountability requirements could be part of a more formal consideration of the performance of ministers by the prime minister. To support this assessment, the ministers of finance and state services could provide relevant accountability information. This would encourage ministers to attend more consistently to the performance of their agencies. As the Rt Hon Simon Upton has noted:

There were – and are – ministers who haven’t read purchase agreements properly or asked about the consequences of their purchasing interests for the fabric of the department or entity in their charge ... the tendency to demand action on politically high profile matters but leave chief executives or boards to take responsibility for the trade-offs is as alive and well today as it ever was.⁹⁴

Structure of cabinet and committees

An idea developed by government officials in the mid 1980s was to have a two-tiered cabinet with an inner cabinet of senior ministers holding the major portfolios and the co-ordination responsibilities across all portfolios. The outer cabinet would consist of portfolios with responsibilities for the administration of the machinery of government. The administrative portfolios would be grouped in a way that enabled the senior minister in charge of a group to develop and implement comprehensive policies across related areas of government. It was also proposed that the top advisory departments would be reorganised to reflect such a rearrangement of portfolios. A small number of high powered advisory departments would tend to each reflect a particular value or point of view, for example wealth creation, civil rights and justice, environment, Treaty of Waitangi issues and social equity.

Such an arrangement, however, could lead to an elite group of policy mandarins at the centre who are cut off from the practical knowledge and policy insight that arises from operational activities. There would need to be a culture of interaction and dialogue between the central policy advisers and the operational people at both official and political levels. It could be seen

⁹⁴ Rt Hon Simon Upton, “Accountability of Crown Entities”, speech to the Legal Research Foundation conference on Shaping the Future State Sector: Balancing Service, Accountability and Efficiency, 21 September, 2000.

that the test of the effectiveness of the strategic policy machinery is whether it was broadly recognised as adding value to the strategic management and operational policy advice emerging from the delivery arms of government. This melding between these two viewpoints is necessary to provide insurance for government against a reversion to an obsolete central planning model from the 1970s.

It was expected that the inner ring of advisory departments would develop the concepts and culture necessary to promote the integration of competing perspectives and analytical disciplines on major policy issues. They would expose the essential conflicts and choices that could not be solved analytically or technically but required political judgement by ministers and scrutiny by parliament. Around this inner ring of policy capability would be an outer ring of ministers and associated departments and officials responsible for the operational work of the government. The proposal was never fully developed and was dropped, partly because of the difficulties of clearly signalling an 'inner cabinet' and partly because of doubts about the merits of adopting a single 'value' as the basis for the focus of an advisory agency. In the current MMP environment it is worth considering these ideas again.

A two-tiered cabinet would address the weakness or inexperience in some parts of the cabinet. Another attraction is in facilitating the imposition of a broad government policy framework across all the portfolios in a way that could encourage more flexible and faster responses to changing national priorities.

The Shipley administration undertook some fresh thinking about the cabinet committees and took steps in the direction of forming a two-tiered cabinet. When the Rt Hon Jenny Shipley became prime minister in 1997, she initiated substantial changes in the operation of the cabinet and its subcommittees. The number of committees was reduced from 12 to seven and the assignments changed as shown in Table 5.1 below.

As well as the strategy committees, there was another powerful and well-established group known as the 'gate-keeping ministers' who were an evolution of an earlier group known as the Cabinet Expenditure Committee. Problems with fiscal control in New Zealand and internationally have provided valuable lessons for governments. Some of the worst situations in the formation of fiscal policy in the 1980s can be attributed in substantial measure to poor decision-making processes in the cabinet. Under the Shipley administration, the gate-keeping ministers were the prime minister, deputy prime minister, the treasurer and finance ministers. They provided a

Table 5.1: Changes to the number of cabinet committees and their assignments; 1997–1998

Cabinet committees as at 3 February 1997	Cabinet committees as at 1 February 1998
1 Strategy and Priorities	1 Strategy
2 Industry and Environment	2 Economic
3 Health and Social Policy	3 Social Policy
4 Education and Employment	4 Legislation
5 Treaty of Waitangi Issues	5 Strategy subcommittee on Expenditure Control and Government Administration
6 Expenditure Control and Revenue	6 Strategy subcommittee on Appointments and Honours
7 Government Administration	7 Strategy subcommittee on Intelligence and Security
8 Legislation and House Business	
9 Appointments and Honours	
10 Strategy subcommittee on External Relations and Defence	
11 Government Administration subcommittee on State Wages	
12 Strategy subcommittee on Intelligence and Security	

spending limit for four ministerial teams that, between them, covered all the government portfolios. The gate-keeping ministers monitored the shape of the budget as it emerged. Once they agreed on an issue, it was most unlikely to be overturned in the cabinet.

Some of the reasoning behind the move to fewer committees was that the previous system spread ministers too thinly and too much of their time had been spent in committees. Consequently, this meant that absences from committee meetings were common and many decisions were reopened in cabinet and debated *ab initio*. Further, the smaller party in the 1996 coalition government did not find it easy to cover the spectrum of issues at committee level, even though it was well represented in the cabinet. Issues would emerge at cabinet that the coalition ministers were not fully familiar with, and sometimes they were not willing to accept the recommendations in the cabinet papers. The issues would then be referred back to the beginning of the process to work their way up again.

As well as reducing the numbers of committees, Mrs Shipley sought further focus through the creation of four ministerial teams to work on issues running across portfolios. The new teams were as follows:

- The economic team led by the treasurer and minister of finance. This team's task was described as 'developing programmes and policies that will encourage and sustain prosperity and growth for all New Zealanders, in particular focusing on measures that will help manage the economic recovery'.⁹⁵
- The enterprise and innovation team led by the minister of enterprise and commerce. Its task was described as focusing on 'what we can do as a government, as communities and as individuals to leverage off our current strong economic foundations, and position ourselves well for the next century'.
- The social responsibility and strengthening families team led by the minister of social services, work and income. Its focus was 'cross sectoral input by government departments, both in policy design and the effective purchase and delivery of services'.
- The justice and security team led by the associate minister of justice, assisted by the minister of justice. This team's task was to 'focus on issues to do with breaking cycles to encourage people who are currently in social crisis to reconnect with society'.

These changes offered the potential for substantial improvement in the conduct of cabinet business. Ministers and officials at the time, in general, reported favourably on how it was working out, although there were weaknesses.

Initially these committees were layered over the top of the budget process. In the budget process relatively small amounts of money were allocated to be spent at the discretion of the committees. The existing machinery for the budget remained dominated by the treasurer, who worked astonishingly long hours to control the whole process personally. The changes may signal the end of the mega-ministers of finance that New Zealand has traditionally had. The Rt Hon Sir William Birch may have been the last. By the end of the term of the Shipley administration some of the influence in the budget process had shifted to the ministerial committees.

The role of government officials in relation to these ministerial committees had a bumpy start. At one budget meeting of ministers the

⁹⁵ Press release from the prime minister, 30 August, 1998.

officials sat in rows looking at their minister's backs while the horse trading proceeded unencumbered by advice or even the barely perceptible nods and frowns by which officials in such circumstances signal their views to their ministers.

The ministerial teams solidified ways for ministers to work together on associated issues. This resulted in increasing numbers of cross-departmental projects being run through semi-formal arrangements using teams of officials. The ministerial teams increasingly directed the strategy and budgeting decisions which meant that their relationships with the other ministers responsible for the administrative arms of government needed to be clear. There was potential for senior strategy ministers to be responsible for junior ministers heading the administrative portfolios.

A two-tiered system for ministers has implications for the relationships between the government departments and ministries reporting to those ministers. There may be benefit, in time, from formalising the cross-department teams through restructuring the agencies where particular relationships are not only proving to be of permanent advantage but are benefiting from the oversight of some senior management. Any rearrangement of government organisations would ideally occur after an analysis of the net gains are judged against well-developed criteria, rather than the sometimes mechanical machinery of government reviews of the past. The SSC, the Department of the Prime Minister and Cabinet and the Treasury should give further thought to meshing the 'machinery of government' work together with the machinery of cabinet. Obviously, such work would not go anywhere without the initiative of the prime minister and senior ministers. It would be more productive if a mandate was given to consider this work. This may well be on the agenda of governments in the future. One prime minister, Mrs Shipley, has indicated a preference for fewer numbers of government departments and ministries and suggested that there be only 15.

The Labour/Alliance government, elected in 1999, reversed these developments in organising the cabinet ministers. A larger number of committees was established as listed in Table 5.2.

Table 5.2: Cabinet committees as at 26 March 2001

- | | |
|----|--|
| 1 | Cabinet Policy Committee |
| 2 | Cabinet Economic Development Committee |
| 3 | Cabinet Finance, Infrastructure and Environment Committee |
| 4 | Cabinet Social Equity Committee |
| 5 | Cabinet Legislation Committee |
| 6 | Cabinet Education and Health Committee |
| 7 | Cabinet External Relations and Defence Committee |
| 8 | Cabinet Appointments and Honours Committee |
| 9 | Cabinet Committee on Government Expenditure and Administration |
| 10 | Ad Hoc Cabinet Committee on Intelligence and Security |

How well this new structure works remains to be seen but a few questions stand out. Economic development is separated from finance, expenditure and policy, which is a novel conception reflecting the forces within the coalition. There are plainly overlaps that will have to be managed, for example, with policies for Maori, when the policy instruments in question are controlled by other committees. How will these overlaps be managed? The Shipley government's delegation of control of related policy areas to groups of ministers was abandoned so the overlaps are now likely to be referred to the policy committee. Similar approaches in the past have caused that committee to overload and choke the central decision-making machinery of government with non-strategic issues. This was the reason for the change in name of the most powerful committee from 'policy' to 'strategy' some years ago.

CHALLENGES FOR MINORITY GOVERNMENTS AND COALITIONS

Minority governments and coalitions require prime ministers to manage the functioning of cabinet with great care. The quality of the working relationships between ministers from different parties and the processes, principles and values by which they explore issues and make decisions have a profound effect on their performance collectively. New Zealand's performance record in this regard has been patchy. Some 'first-past-the-post' cabinets that contained dominating personalities lacked the ability to manage disputes. The prime minister in the Muldoon administration overwhelmed the cabinet processes and culture, placing his colleagues at the

margins and reducing their ability to contribute. The 1984 Labour government struggled for harmonisation of deeply embedded differences for most of its time in office. Notwithstanding the fact that it was a powerhouse of policy formation in so many areas, the government's internal schisms were a substantial influence in its electoral defeat. Difficulty in reaching creative resolution of similar tensions in the 1990–93 National government also carried a cost in terms of policy making and credibility with the electorate.

The arrival of a coalition government in 1996, and its dissolution into a minority government in 1998, raised by an order of magnitude the potential for damage from a lack of attention to decision-making processes. Ministers and departments experienced a rapid learning process. This was accompanied by some well-publicised failures, eventually leading to the dissolution of the coalition. The dissolution was ostensibly over a procedural matter of whether the commitments in the coalition agreement about which government assets were eligible for privatisation overrode the *Cabinet Office Manual* with regard to how decisions were taken in cabinet. Although the real reasons for the coalition collapse lay elsewhere, the incident showed that prior agreements about decision-making processes and dispute resolution are crucial to the ability of a multi-party cabinet to function.

Another issue requiring attention is the awkward status of a 'coalition agreement' – an agreement over policy between political parties in a coalition, before it has been translated into formal government policies. These are manifestos and, as such, are the intentions of political parties, not government policy. In the first appearance in New Zealand of a coalition agreement after the 1996 election, there were problems with interpretation. The requirement to provide free and frank advice was still in chief executives' performance agreements. In the past, officials have offered free and frank advice about manifesto undertakings as part of the processes of developing laws and government policies. Party manifestos are developed by non-transparent processes. These manifestos can be hijacked by energetic minorities within a party organisation whose membership is a minute fraction of the country's population. Good government requires that these proposals be tested within the full machinery of government decision making before becoming government policy or law.

The public has a right to expect that the policy advisers, whose salaries they are paying, are not prohibited from doing their jobs. Some ministers in the Labour/Alliance government in 2000 have shown a disappointing tendency to try to suppress advice from officials and to advance policy

proposals with no background analysis or plans for implementation. For example, there was strong objection to the Treasury providing submissions on the effects of profound changes in labour laws. The policy on 'closing the gaps' between Maori and the general population seems not to have been thought through properly or to have been the subject of thorough advice from officials.⁹⁶ This failure has proved to be costly to the government, both politically and in terms of the progress of policy towards Maori. Several advisory agencies set out their concerns about a lack of proper consideration of the government's health reforms.

The Treasury, the State Services Commission, Te Puni Kokiri and the Crown Company Monitoring Advisory Unit shared concerns about some of the conclusions in the Ministry of Health's cabinet paper about health and disability sector changes in relation to insufficient analysis of a number of conceptual and practical considerations: "this paper does not, in our view, adequately deal with the difficult and possibly confused accountabilities, or the competing and opposed incentives, not to mention the significant conflict of interest, inherent in the proposed relationship between the district health boards and the public hospitals and other publicly owned provider organisations".⁹⁷

The Treasury noted that, with regard to the 'closing the gaps policy', "the analysis to underpin these decisions has not been undertaken and their costs have yet to be identified". Subsequently the policy was dropped.

The advice of government officials, which proceeds through ministers to cabinet, and that questions the feasibility of a coalition agreement can create severe tensions. For example, under the 1996 coalition government, there were substantial public differences about the health policy between the minister of health from the National Party and the associate minister of health from the New Zealand First Party. Their interpretation of the coalition agreement on health differed. Officials are required to follow the direction of ministers, which means the senior minister if there is disagreement. A difficult situation was created for officials when they were directed by the associate minister of health to carry out work in line with that minister's interpretation of the coalition agreement which differed from the senior

⁹⁶ See "Health Clause Vital for Maori Patients", Sandra Coney, *Sunday Star-Times*, 5 November, 2000, p 8.

⁹⁷ Minister of Health's cabinet paper setting out the reforms, titled "Health and disability sector changes and their implementation", www.executive.govt.nz/minister/king/health.

minister's interpretation. The associate minister enjoined officials to adhere to the 'letter and the spirit of the coalition agreement', which was sometimes a perplexing instruction because the document itself was a compromise between quite different views of how the health sector should develop.

New protocols about how officials carry out their duties in these circumstances would help to reduce the consequent disruption to the relationship of coalition ministers when considering the advice of officials. Such agreements also raise deeper questions about how much detail the parties attempting to form a coalition government should attempt to resolve at the time they are forming the agreement to govern together. The 1996 agreement had considerable operational detail and was forged in the absence of comprehensive advice on the costs and benefits of what was agreed. The robustness of many of its policies has been questioned. By contrast, the Labour/Alliance coalition agreement following the 1999 election was much more simple and outwardly effective.

The central agencies

The Department of the Prime Minister and Cabinet is a key resource for the prime minister in managing policy and other issues across the government. It has played an important role in the past in assisting the government with the processes to develop its goals and strategies. It is not yet clear how much importance the 1999 Labour/Alliance government will place on the goal-setting process. It began with a very dismissive attitude to strategic management but will probably change over time.

The other two central agencies (the Treasury and the SSC) hold critical roles in assisting ministers to set expectations for government agencies in their portfolios, and to monitor these.

The Treasury supports the minister of finance and the treasurer to carry out their functions.⁹⁸ In addition to powers associated with this work, the Treasury has powers to require information and to issue instructions under the Public Finance Act 1989 and the Fiscal Responsibility Act 1994. The Treasury states its three central roles as:⁹⁹

- providing advice to improve the economic and fiscal framework for high levels of economic growth and improved living standards;
- monitoring and managing the financial affairs of the Crown; and

⁹⁸ At the time of writing, the current minister of finance is also the treasurer.

⁹⁹ The Treasury, "Department Forecast Report to June 2001", Wellington, p 12.

- assessing and testing other agencies' advice and proposals that have economic and fiscal impact.

This work includes:

- advising on the annual budget and preparing the budget documents;
- reporting on expenditure proposals;
- managing the public debt;
- providing policy advice on issues that have economic and fiscal implications;
- providing strategic advice for ministers and cabinet on the future shape and direction of the economy;
- financial monitoring;
- financial reporting including reports on Crown assets, liabilities, revenue, expenditure, cashflows, borrowings, contingent liabilities and commitments;
- assisting government with reports on fiscal policy intentions and results (for example, fiscal strategy reports and economic and fiscal updates); and
- monitoring the ownership interests in Crown-owned companies and state-owned enterprises (through an independent unit formally part of the Treasury).

Ministers have had access to advice to assist them in making decisions on economic and fiscal policy directions and decisions on spending on new initiatives. Where they have been less well endowed with support is in the area of monitoring the efficiency and effectiveness of departments and ministries.

One of the state services commissioner's roles includes reviewing the performance of departments and ministries. A former minister of state services, the Rt Hon Simon Upton, was very active in encouraging the SSC to develop its monitoring ability. He encouraged the commission to move to a more forward-looking monitoring approach, with an emphasis on the development of capability in ministries and departments.

More can be done to enhance the ability of the Treasury and SSC to assist ministers in assessing performances.

The roles of the Treasury and the SSC with respect to value for money are more complicated. Both the Treasury and the SSC have roles in advising and monitoring the efficiency, effectiveness and capability of ministries and departments. The Treasury's activities focus on policy advice to the government, assessment of spending proposals and monitoring fiscal

matters. The SSC has the role of monitoring efficiency, effectiveness and capability in relation to the performance of chief executives. There are gaps in this monitoring, including a lack of monitoring of purchase agreements, a lack of a systematic approach to monitoring efficiency and limited assessments of the effectiveness of ministers and departments.

There are three main sources for these gaps. The first is the approach the SSC chose to take to its monitoring function. It could have been more active in monitoring purchase agreements, and in promoting and using benchmarking information on efficiency and monitoring capability. The second source lies in the way the two agencies work together. The Treasury has skills and knowledge to contribute to establishing better approaches to assessing efficiency, effectiveness and capability. The Treasury and the SSC could work together more closely, with the Treasury providing advice and assistance with assessments. At the time of writing there were productive developments occurring with regard to a wider integration and co-ordination between central agencies.

The third source is the expectations that ministers place on departments and ministries. Ministers have the power and mechanisms to create performance incentives for departments and ministries through the expectations they have about performance, such as expectations that significant policies will be evaluated. Ministers could do more to strengthen the incentives influencing performance, particularly the incentives for evaluation.

VIEWS ON THE PERFORMANCE OF MINISTERS

There is little systematic evidence about the effectiveness of ministers in the administration of their portfolios to assist in forming a reliable picture of their performance. The best source for this evidence would be the views of senior departmental executives who have worked for numerous ministers, but they are silent on the subject through discretion and obligation. The reputations of ministers in their administrative roles are well known but unrecorded.

Table 5.3 below contains the results of a structured anonymous survey of the views of a sample of senior managers in government departments about how ministers and other politicians have adapted to the changes in management systems.¹⁰⁰ The results of this survey suggest that some

¹⁰⁰ Doug Stace and Richard Norman, "Reinvented Government: The New Zealand Experience", *Asia Pacific Journal of Human Resources*, 1997, Vol 35, No 1, pp 21–36.

ministers do not understand the functioning of the public management system.

Table 5.3: Views of a sample of senior managers about the response of ministers and politicians to the management reforms

Given the anonymity of the Decision Support system, participants expressed a range of views about their ministers. Two comments that were subsequently agreed through the questionnaire were:

- Agencies have changed but not parliament.
- Ministers sometimes have difficulty in defining their expectations.

Criticisms of elected representatives included:

- Ministers do not seem to have changed as much as departments have. This can lead to conflicts with chief executives, especially those coming into the public sector from the private sector.
- The understanding and acceptance of the management system by ministers is poor. They are not as ready to accept the accountability that the new order demands.
- Infighting in cabinet means that only lip service is paid to some aspects of 'collective interest'.
- I am worried that the public service is no longer as non-political as it used to be. The processes that were in place to protect political interference and nepotism seem to have disappeared.

Not only government representatives came in for criticism. One person felt that there were "insufficient controls on opposition members who waste the time of executives".

Comments about relationships with politicians were not entirely negative. Optimists felt there was a major benefit in the new clarity of roles and the focus on outputs. This makes for a sharper distinction between politicians and their advisers and enables ministers to gain better information. The distinction between the roles of senior managers and ministers means that ministers are more aware of when they introduce political factors into their decisions.

The Rt Hon Simon Upton, a minister of state services, commented at a public sector conference in 1999 that "improving the performance of ministers is truly problematic". He said that senior public servants must bear the cross of attending to the long-run ownership interests because ministers rotating through portfolios will generally not do that.

To improve the performance of ministers would require them to gain knowledge about the significant issues in relation to ministerial performance and about the beliefs and circumstances underpinning ministerial

behaviours. A prime minister and cabinet that are seriously interested in lifting the performance of ministers could begin by getting a well-structured elucidation of the views of former prime ministers, ministers and senior public servants. It would be useful to understand what behaviours and beliefs are associated with the ministers who are, or have been, effective in giving direction and in providing ongoing oversight to government agencies.

ROLES OF MINISTERS

Ministers have a political management role as well as roles in setting directions and taking an oversight of agencies. Political management extends across policy, the desires of constituents, media issues, the wishes of lobby groups and the public, the politics within the government and the workings of parliament. Ministers' roles in relation to their agencies require particular skills, different from those used in political management.

Ministers with skills in managing personnel are very rare. Few have had professional backgrounds in which they have been required to use these types of skills. Some ministers are very awkward in dealing with personnel issues. There have been instances of ministers being quite unfair in their appraisal of the performance of a chief executive. There have been cases of ministers largely ignoring the senior officials in their departments and working around them with members of the minister's office staff. In such cases, relationships between the minister's private office staff and the department can become poisonous and dysfunctional. A few ministers have been known to undermine the chief executive of the department by letting it be known widely that they have no confidence in the individual. In one such case the minister was, however, reluctant to take action to have the individual dismissed, even though that possibility had been raised in the appropriate way.

Ministers would benefit from focused training and assistance in the management of chief executives and the setting and monitoring of performance expectations. The SSC and the Department of the Prime Minister and Cabinet should develop a short, sharp training programme for newly appointed ministers and should also provide for ongoing assistance.

SETTING PERFORMANCE EXPECTATIONS

From the outset of the reforms, Hon Stan Rodger was concerned that some ministers may not be up to the role of dealing in an arm's-length and

sometimes directive way with strong-willed and well-informed chief executives who could have their own agendas and priorities.

Geoffrey Palmer had similar concerns:

One problem from a political point of view is that the system requires more from ministers than the old one did. There are some ministers who like being told what to do by their chief executives. It means that they do not have to bother thinking too much. The new system requires ministers to know what they want, to be able to articulate it and negotiate a performance agreement about it. I think this is desirable, it is simply not an easy matter to achieve sometimes.¹⁰¹

Indeed, it was not until 1991 that cabinet made performance agreements compulsory for all chief executives. Considerable progress has been made since but there is still some way to go before good practice principles are applied to all performance agreements.

Many senior ministers, over the whole period since the reforms, have been concerned, more or less privately, that some of their colleagues are weak in playing their parts in the performance management process. The Rt Hon Simon Upton, a former state services minister, noted that:

While ministers labour over purchase agreements, knowledge about the ability of departments to deliver is left almost entirely in the hands of chief executives.¹⁰²

More attention is needed to the role of ministers and to a strengthening of their ability to carry out their role.

The processes that ministers use for setting the performance requirements of departments raise different possibilities, and a number of variations in the setting of the requirements have been observed. Some ministers are determined to ensure that their purchase agreements and strategic goals are established independently from the views of the servicing department. When Simon Upton held the science and environment portfolios, he took an uncommonly pure view when he stated:

With respect to my own science and environment portfolios I can say that my outcomes are not and have not been written by either ministry. I would not want them involved in this way. I shouldn't think they would want to be involved, because they would then be intolerably compromised in terms of their independence and their ability to give free and frank advice. They could not give such advice if they were trying to get into outcomes.¹⁰³

¹⁰¹ G Palmer to G Scott, 1994.

¹⁰² Rt Hon Simon Upton, media release, 7 September, 1999.

¹⁰³ Rt Hon Simon Upton, speech to the New Zealand Institute of Public Administration seminar, 1995.

At the time the management system was introduced, senior ministers feared that the weaker ministers would not be competent with regard to setting performance requirements and that they would become captured by their departments. Ministers would, in effect, then just be signing off on the department's own proposals as to what it thought it ought to be doing. In 1988, the government provided each minister with \$50,000 to be spent as required on purchase advice to ensure that the ministers had carried out their responsibilities to shape the directions of their departments. Over the ensuing years, some ministers have employed outside consultants or members of their office staff to scrutinise departmental proposals from this perspective or to generate proposals of their own. The concept of a purchase adviser has been developed in various ways, according to the circumstances of various portfolios, but could well be developed further.

The central agencies also challenge departmental proposals for policy initiatives and expenditure through the development of the government's strategic goals and through the budget process. Some ministers draw quite heavily on the resources of central agencies in the development of their purchase agreements. The central agency ministers, at times, bring in outside advisers to help them develop purchase agreements for those agencies.

In the most effective relationships between ministers and chief executives the department has a detailed involvement in the development of the purchase agreement. This is not evidence of capture so much as evidence of an effective working relationship between the supplier and the receiver of the department's services. Even where a minister has the ability and resources to establish requirements of a department in an independent way, it is still essential that there is a detailed dialogue with the department that ensures ownership by the department of the minister's objectives.

It is equally important that the department's obligations to give free and frank advice, and to consider its own strategic directions for the longer term, are seriously considered by the minister in the dialogue leading to the purchase agreement. Effective departments are not only the recipients of directions from ministers, but are active participants in the dialogue about what is to be done. An effective chief executive and management team are professionally committed to carry out the directions of government, whether they agree with them or not, while at the same time being clear in their advice about what they think should be done. An effective relationship between a chief executive and a minister will normally involve vigorous disagreement at times. This is not just about particular issues but about the direction of the strategic policy.

This perspective does not place departmental advisers in a position of excessive influence in relation to ministers. It is a vitally important check on the quality of policy decisions made by the government.

LIFTING THE PERFORMANCE OF MINISTERS

Information

The New Zealand public management system has sharp instruments for measuring chief executive accountability, but blunt ones for ministerial accountability. A key gap is the lack of information on the financial and other performance of a minister's portfolio. The failure to consolidate Crown entity and SOE accounts into the government accounts accentuates this gap. There could also be reporting of ministers' performance on a portfolio basis, which would be timely enough to expose performance problems. In the health sector, the increase in hospital costs and the output levels have never been sufficiently transparent for readers of the government accounts to assess the performance, across time, of the minister of health on these indicators. The public hospitals are Crown entities and appear in the accounts only in relation to their net worth. This problem will be addressed through the application of emerging new international standards for public sector accounting and reporting. The minister of state services has indicated support for ministers and chief executives to submit joint annual reports to parliament that could provide impetus to ministers to attend to ownership interests as well as to the outputs and other performance of their departments and ministries.¹⁰⁴

Training

Comments made by new MPs over many years suggest that the process of induction into the ways of parliament and government is weak and could be much improved. A better foundation for ministers could be laid by ensuring that MPs are knowledgeable on all critical aspects of the public sector management system, including the rights, responsibilities and accountabilities of parliament, government, ministers, MPs, select committees, the central agencies, statutory officers, chief executives, commissioners, boards of government organisations and public servants generally. MPs should be

¹⁰⁴ Hon Trevor Mallard, minister of state services, "Complying with the new government's priorities and plans for improving public sector performance and accountability", speech, 3 May, 2000.

schooled in how the systems and processes operate in parliament and government.

Ministers need to be fully aware of the different rights, responsibilities and accountabilities of the organisations and individuals in their portfolios and, in general, across government. This is particularly important for ministers with SOEs and Crown entities in their portfolios. Success in working with these boards requires good governance practices on the part of the minister and well as the boards. Guidance for ministers in this area could be valuable. When the Labour government was elected in 1999, the prime minister and minister of finance from the previous Labour government, Rt Hon Sir Geoffrey Palmer and Hon David Caygill, undertook some training activities for the new ministers. This sets a useful precedent.

Greater emphasis should be put into developing the skills of the MPs who are promising candidates for cabinet. Cabinet selection is always going to be different in important respects from the identification and development of potential top managers in the private sector and within government institutions. This said, the process by which it is done in respect of cabinet ministers is notably ad hoc and personalised in contrast to good practice elsewhere. For the politicians who show the necessary potential and aspirations for cabinet rank, the processes of succession planning and work allocation within the political parties should be more influenced by the principles of good practice in other sectors.

In addition to developing practical skills through caucus and select committees, and through under-studying senior ministers, aspiring cabinet ministers would benefit from greater participation in targeted academic training in policy analysis and in public management. It is a credit to several ministers and senior politicians that they have made the commitment to self-development of their professional skills during periods in opposition. The numbers doing this are, however, too few.

Remuneration

The remuneration of ministers is one aspect that influences the willingness of people who are considering political careers to enter politics and take their chances on being a minister. The influence of salaries on the pool of ministers would not be easy to research. It is apparent that ministers are influenced by the years that it takes to qualify for a pension in the decisions they take about entering and leaving politics, so it can be inferred that they are significantly influenced by money. Once in cabinet, however, they usually find it hard to state in public that the taxpayers should be prepared to pay good salaries if

they want good ministers. Commonly they turn down increases or say they do not need the money. Some ministers I have known personally believe that they are very well paid and do not need increases.

All that can be said with certainty is that remuneration is a factor that influences the depth and quality of the pool of talent that is available to the parties from which to select ministers. Ministers will regard their salaries in the same way most other employees do. It is an important factor that will influence some individuals more than others. It will have a decisive impact at different stages in people's lives. If remuneration is perceived as very low by comparison with other opportunities that people have then it will have a very negative impact. While some people with great talents will make themselves available for very little, it is very hard to assess how many more people would be available if salaries were higher. Every cabinet I have had contact with over 23 years had a tail end that was really struggling to get on top of its responsibilities.

In the later 1990s there has been a tendency for ministers to take a more hands-on role in the management of public organisations. If this trend continues it is even more important that ministers are available for duty who have advanced professional and managerial skills.

Over the long haul, salary is a factor in determining the pool of ministerial talent. Most democracies face this problem and few solve it – especially in countries where ministers are drawn only from the legislature.

A less democratic country, Singapore, is unequivocal on the subject. It issued a white paper in 1994 on this topic from which the following quotes are drawn.

Competent political leadership is crucial to good government. Singapore must draw its ministers from among its most outstanding and committed citizens. It must find a continuing flow of men and women of ability and integrity, who will govern the country, mobilise the population, and chart future directions for the nation. Without such ministers the competence and integrity of government will suffer. Singapore will be unable to overcome problems, anticipate challenges and exploit opportunities the way it has done. It will lose this vital competitive edge over other countries, which enables it to thrive and prosper, and compensate for its smallness, vulnerability and lack of resources ... Able Singaporeans are eager to pursue challenging, fulfilling and remunerative private careers. They have little incentive to take on the risks and public responsibilities of a political career.

Salaries should never be the motivation for persons to become ministers. A sense of duty and public purpose, and the desire to contribute to the nation and have a say in its affairs, are essential. Many of the personal sacrifices people make to enter politics are unavoidable. But the financial sacrifice is the simplest to minimise, by paying realistic salaries comparable to what potential ministers can

earn in the private sector. While it is not possible or necessary for ministers' salaries to equal the highest private sector incomes, if the financial sacrifice of becoming a minister is too large, it will be another obstacle to able Singaporeans entering politics.

Singapore has opted for paying ministers a realistic, clean wage, rather than a low salary and a host of hidden perks. This is more transparent and accountable, and more honest to the electorate. However, such an approach makes it incumbent on the government to confront the problem openly and directly, justify why ministers should receive proper salaries, and establish a mechanism for fixing these salaries and keeping them in line with the private sector.¹⁰⁵

This perspective was translated into a policy of automatic salary adjustments whereby ministers at the 'entry level' are paid two-thirds the average income earned in their professional capacity by the top four individuals from each of six professions.¹⁰⁶ Singapore has a corporatist government and the mandarin tradition of public service. It is easy to argue that its approach to ministerial salaries is of no relevance to New Zealand, or is it? Would the paragraphs above really seem out of place here if the name of the country were changed?

Codifying requirements for good practice by ministers

The *Cabinet Office Manual* is the obvious vehicle for strengthening and codifying expectations for effective ministerial conduct. It could be expanded to cover principles for good practice in relation to duties under the State Sector Act 1988, Public Finance Act 1989 and the Fiscal Responsibility Act 1994. It could also deal with expectations in managing ministerial responsibilities for SOEs and Crown entities. It should deal with the cabinet's own processes for developing and monitoring the government's progress in achieving its policy goals.

ASSISTANCE FROM ADVISORY BOARDS

An idea of some years' standing is the placing of advisory boards to oversee government departments. The boards can assist chief executives by providing an overview of management decisions. They can also provide some assurance to ministers that extra attention is being given to key policy areas. The advisory boards have, to date, been set up and managed by chief executives rather than ministers, but this is not the only management option possible.

¹⁰⁵ *Competitive Salaries for Competent and Honest Government*, Prime Minister's Office, Republic of Singapore, White Paper presented to Parliament, October 1994.

¹⁰⁶ *Competitive Salaries for Competent and Honest Government*, *op cit*, p 12.

The advisory boards raise issues of constitutional accountability. The State Sector Act 1988 is clear that the chief executive is accountable for the conduct of the department, so a serious ambiguity would be introduced if a chief executive were to accept a direction from a person other than the minister. In these circumstances, would the board be accountable for the actions of the department? If the advisory board were acting simply as an agent of the minister, then the State Sector Act 1988 would prescribe and restrict the board's powers of control over management decision making just as it limits those of ministers.

Where there are sound reasons for an advisory board to be placed in control of a government agency, consideration could be given to creating a Crown entity. The reason for this suggestion is that, as a separate legal body with an advisory board appointed by the minister, Crown entities do not raise the same constitutional complexities that occur when boards are placed over government departments. Crown entities do, however, have government accountability issues and these are discussed in chapter ten.

One approach to bringing the benefits of governance by an advisory board to a government department, without causing fundamental constitutional problems, has been the appointment of advisory boards to the branches of some government departments. Chief executives appoint these boards because they bring skills and an independent point of view not otherwise available to the chief executive. The first of these advisory boards was attached to the New Zealand Debt Management Office, which is a branch of the Treasury. It was chaired by Sir John Anderson, a senior figure in the banking sector, and included people with skills in financial portfolio analysis, the auditing of complex financial institutions and other relevant areas. Before the restructuring of the social welfare agencies in 1998/99, the Department of Social Welfare placed advisory boards over its main constituent activities, such as the income support service. The chief executives who created these boards regarded them as making a valuable contribution to running their departments.

There are, however, limitations to the authorities for management that chief executives can delegate to these boards, because the Public Finance Act 1989 and State Sector Act 1988 constrain the powers of delegation. In particular, a chief executive can delegate responsibilities for personnel management only to people employed under the State Sector Act 1988. The two acts are also clear about the personal accountability of the chief executive for finance and personnel. The requirements that chief executives run their operations in ways that allow them to meet the requirements in these acts can limit the amount of influence that an advisory board can have. Chief

executives must comply with the State Sector Act 1988 and the Public Finance Act 1989 and be open to accepting advice from the board, within the bounds set by those Acts, or people would not be willing to go on the advisory boards.

In the case of the former Department of Social Welfare, the director-general's retention of the control of policy and personnel decisions met the requirements of the State Sector Act 1988. The advisory boards were, in effect, monitoring the ownership interests in the constituent operations of the department. The boards are concerned with questions of finance, efficiency and good management practice. The director-general at that time, Dame Margaret Bazley, has spoken highly of the service that the boards performed in increasing the effectiveness of the Department of Social Welfare.

As a practical matter, ministers can have discussions with these boards about departmental affairs. In one instance, the minister of finance had a meeting with the advisory board of the New Zealand Debt Management Office without the presence of the secretary to the Treasury. The chief executives concerned have been relaxed about such contacts and I am not aware of any incidents where the fundamental accountabilities of chief executives have been compromised by these innovative arrangements.

Because experience to date with advisory boards in this role has been positive, I believe they surely have a wider contribution to make. The SSC should conduct an appraisal of the many years of experience with advisory boards in some government departments. The review should be used to draw together and develop best practice principles.

The following observations are relevant in this context. The restrictions on the delegation of responsibility to boards do not present many problems in practice and are desirable in order to ensure accountability to parliament. In the same vein, ministers cannot delegate responsibility to boards for setting and monitoring performance, although ministers are free to seek advice from any source, including an advisory board, on those subjects. Neither the minister nor the chief executive can delegate to a board their own responsibilities under the State Sector Act 1988 and Public Finance Act 1989. A chief executive has responsibility to give free and frank advice and to manage the department effectively and efficiently. This cannot be passed to a board. These boards offer a way of having a Crown entity-type governance arrangement over the ownership interests of the department, while preserving traditional direct ministerial control over the purchase interests.

The experience of the Reserve Bank of New Zealand could be included in the review. Although it is established by its own legislation, the practical

operation of its board would be interesting to consider in view of the requirements on the governor to act independently. I was a member of the board before the passage of the Reserve Bank of New Zealand Act in 1989 and found the board to be a pointless forum because the governor's advice was not subject to board control and the minister of finance made all the decisions. The 1989 legislation carefully balances the roles of governor, minister and board. These will be fine-tuned following a review completed in 2001. The Reserve Bank of New Zealand provides a sophisticated case study for others who are thinking about the development of boards in public organisations.

To date, chief executives appear to have initiated most of the instances of advisory boards in departments. The option to use boards should generally remain at the discretion of the chief executive of the department. There have been cases, however, where individuals or boards have been placed in a department because of SSC concern over performance. If a minister was to insist on there being a board put in place in the face of resistance by the chief executive, it is hard to imagine the arrangement working. The chief executive could easily starve the board of information and bypass it by dealing directly with the minister. Further, for a minister to insist on a board over the objections of the chief executive would be likely to indicate that the minister had lost confidence in the department. Other remedies would be more appropriate.

In February 2000, the minister in charge of Work and Income New Zealand (WINZ), the Hon Steve Maharey, insisted that the departmental chief executive, Christine Rankin, terminate the board she had appointed to assist her.

Mrs Rankin and I have discussed my expectations for WINZ regularly since the election. My associate ministers ... and I, have adopted a firm hands-on approach to our oversight of WINZ. We are determined to provide clear direction on the sort of culture we wish to build within the WINZ and we do not see a role for this board any longer. Our objective is to achieve a culture change within WINZ that reflects the roles and responsibilities of a core public sector department. An advisory board made up of private sector representatives charged with influencing strategic direction could be in conflict with this objective.¹⁰⁷

Behind this incident there must surely have been questions of confidence and possibly of the minister's views of the individuals on the board. It was a

¹⁰⁷ Hon Steve Maharey, "Board goes as Maharey sets new direction for WINZ", *The Dominion*, 2 February, 2000.

defining event concerning departmental boards and has set a poor precedent. For the reasons given above the appointment of a board and its removal should be a decision for the chief executive. As in all matters of management that are likely to impinge on the minister, the chief executive should keep the minister informed and consider any comment that the minister wishes to make. A chief executive would be unwise to put people on a board whom a minister had expressed disapproval of in terms of their skills or orientations to the minister's policy interests. The presence of board members with known views that are contrary to government policy would cause friction between the chief executive and the minister, even though these boards can have no effect on the chief executive's accountability to the minister to deliver government policy.

In the WINZ case, some accommodation between the chief executive, the board and the minister should have been found. It seems to me to raise a matter of lack of confidence by the minister in the chief executive whose performance, as it happens, was under scrutiny for the chartering of an aircraft to take WINZ staff to a training seminar. As I see it, the chief executive should have responded immediately to any implications that the minister saw the board as having for government policies, even to the point of removing the board if they were substantiated. But, if this were the case, then the board should probably not have been appointed in the first place. These boards should have responsibilities for oversight of management, not policy.

Having dealt with whatever policy issues were in contention, the chief executive should then have insisted that the discretion remained with her as to whether or not to have the board to assist her in the conduct of her management responsibilities. If she chose to abolish it then so be it, but the initiative appears to have been the minister's. He was crossing the line on the role of a minister, because the State Sector Act 1988 gives chief executives and not ministers the role of managing departments.

The WINZ incident has made it urgent that the SSC develop a policy, in consultation with the minister of state services, that establishes clear principles for the use of advisory boards.

The inquiry in 1999 into the Inland Revenue Department by the Finance and Expenditure Committee¹⁰⁸ recommended that the government consider

¹⁰⁸ Report of the Finance and Expenditure Committee, *Inquiry into the Powers and Operations of the Inland Revenue Department*, New Zealand House of Representatives, 1999.

establishing a board of directors to provide an oversight of the department's operations. The Committee said that the board could be modelled on the board of the Reserve Bank of New Zealand in that it would have general oversight of the department but it would not be involved in the operations nor limit the statutory powers of the commissioner. The board would provide independent reports on the health of the tax system, the stewardship of the department, the operation of the penalties regime and the strategic direction of the department.

This proposal glosses over some of the points made above. The proposal seems to involve the board in both policy and ownership issues. What is the meaning of the word oversight? Does the board have any decision-making power or can it only write advisory reports to the minister? Would people with the necessary expertise join the board if it only wrote reports? What are the implications of the fact that the commissioner is appointed and assessed by the SSC in respect of stewardship whereas the governor of the Reserve Bank of New Zealand is not? The operation of the penalties regime is the responsibility of the commissioner under law so would the board have any powers to impose its own interpretations over the commissioner's? Surely the strategic direction of the department is the responsibility of the government? Is the board of the Reserve Bank of New Zealand a good model?

Reports required on the health of the tax system would be incredibly broad and, at times, inevitably embarrass the government unless the board appointment process was largely politicised. Such a body would quite likely have recommended a capital gains tax to the Hon Ruth Richardson, which would have been pyrotechnically interesting. If the board were to be covered by the doctrine of free and frank advice then it would be taking on some of the protections accorded to the public service. How would this fit with the board being the minister's agent in overseeing the department?

In the United Kingdom a board has been established in the Inland Revenue, with ambitious goals. The advertisement in *The Economist* for board members stated:

... you will be a key figure in shaping our strategic service delivery for the 21st century ... As one of a board of five you will be responsible to the executive chairman and take the lead in the radical reshaping of our service to the public.¹⁰⁹

The position carries a salary of £117,000, although "exceptional flexibility will be considered for an exceptional candidate".

¹⁰⁹ *The Economist*, 4 September, 1999, p 7.

The notion of a board that assists in the governance of a complex organisation like Inland Revenue is sensible but unless the questions asked above are resolved in a way that conforms to sound principles of ministerial accountability, governance, management and the statutory independence of the commissioner, then it would fail.

CONCLUSION

The performance of ministers can be pivotal to the performance of the government organisations in their portfolios. These organisations respond to their ministers' strongest pressures. A minister can be a positive influence, a disturbing influence or of little influence at all.

There are four possible directions for lifting the performance of ministers. One is to induct them as MPs and prepare and support them as potential ministers, and, once selected, to provide training and continual support through the provision of published guidelines and purchase advisers. The second direction is the use of formal reviews by the prime minister to assess how well ministers are meeting their requirements as 'vote' and 'responsible' ministers. These reviews should provide feedback to ministers on all dimensions of their performance.

The central agencies could also provide valuable support to ministers through the changes being made to develop the capability of the SSC, and through the suggested improvements to the cabinet and government documents and processes once these have been undertaken.

The third direction is to provide better information for ministers and others so that the performance results are visible for the full portfolios that they hold. This change would involve arranging financial and other performance information by portfolio and by including SOE and Crown entity information.

The fourth avenue is to improve the ability of ministers to manage their portfolios by arranging them under areas, with senior ministers taking charge of the policy and strategy and junior ministers carrying the administrative portfolios. The use of ministerial teams like those developed under the Shipley administration could evolve into this arrangement. So far, the Labour/Alliance government seems to have turned away from this approach, although the current prime minister can be firm in dealing with performance problems in the cabinet.

6

THE HARD EDGES OF ACCOUNTABILITY: SOME PRINCIPLES AND CASES

INTRODUCTION

Concepts and systems of accountability have evolved since the State Sector Act was passed in 1988, in response to the lessons of experience and the evolution of the underlying thinking behind the principles of the management system. Inevitably, it is the controversial cases that define the hard edges of the relationships, responsibilities and accountabilities between ministers, departmental chief executives and Crown entity boards. This chapter discusses the principles applying to the roles and responsibilities of these parties, in more depth than chapter four, and considers the implications of some case studies on the accountability of departmental chief executives. The focus of this chapter is on the relationships between ministers and departmental chief executives. The absorption of the implications of these cases by ministers and chief executives for the underlying principles of the management system is important to its further refinement and development. These cases are tests of the principles of the management system in action and provide justification to embed or change the accountability requirements of chief executives as necessary.

CONCEPTS OF RESPONSIBILITY AND ACCOUNTABILITY

Publications from the SSC define responsibilities of departmental chief executives as duties and functions, whereas accountabilities are the requirements of chief executives to explain fully and accurately to those in authority the exercise of those responsibilities.¹¹⁰ The SSC has noted that the terms responsibility and accountability are sometimes used interchangeably. The term 'ministerial responsibility' covers both responsibility and accountability because it includes the duty to explain and report to parliament.

¹¹⁰ State Services Commission, *Responsibility and Accountability: Standards Expected of Public Service Chief Executives – Key Documents*, Wellington, June 1997, p 8.

Ultimate political accountability for management

The responsibilities of chief executives for the effective operation of their departments are delegated by parliament. The framework for the public sector is set out in legislation and conventions, and in the management systems that are developed under these. The government is ultimately accountable to the electorate for the performance of the public sector. Chief executives have delegations under law, as well as responsibilities under performance agreements, for the operation of their organisations.

There are legislative restrictions on the power of ministers to intervene in some management matters. When parliament legislates to create a framework of public administration that restricts the powers of direct intervention by ministers in the management of departments, parliament can be assumed to have done so on the basis that this legislation will serve the public interest. For example, this could be in areas where, in order to promote transparency and avoid patronage and corruption, discretionary decisions are better taken by politically independent officials rather than politicians. The public may not always like the decisions of public sector managers, but this does not mean they would want the decision-making power removed and instead exercised by politicians.

There is general acceptance by politicians and the public that, for practical day-to-day purposes at least, chief executives have a distinct accountability that is separate in many respects from those of their ministers. In normal circumstances, the public and politicians look to public agencies for that accountability, rather than directly to the ministers. Select committees of parliament examine departmental performance routinely with no involvement of ministers.

While senior public servants are accountable for the management and delivery of their services, they are well aware that if their administration causes a substantial political problem, then politicians will not stand back. They are likely to find themselves enmeshed in a political response that is outside the processes of routine performance management and assessment. Politicians cannot expect to be unaffected by substantial managerial failures in departments and, if the failures are serious enough, the public expects the ministers to be politically accountable even if they did not have any direct influence over the cause of the failure.

This accountability by politicians for the management of their departments when things go seriously wrong has several foundations. The public will not accept that a minister can hide behind his or her 'employees' if there is a serious problem. Palmer and Palmer observe that:

The constitutional doctrine of individual ministerial responsibility is primarily about requiring ministers to answer in parliament and fix up mistakes. They must inform parliament about and explain to it the activities of their departments and the exercise of their powers and duties. They should also investigate problems, fix them, and report the results to parliament.¹¹¹

There has been a marked change towards greater autonomy by chief executives in the management of their departments but this autonomy has limits. Ministers are not only still accountable but they also still exert control, in practice, by the nature of the decisions they make, for example, decisions on policy, performance agreements, budgets and what goes into legislation. Ministers also exert control over departments by what they communicate, often informally, to their chief executives about their philosophy, what is concerning them and how they prefer to do things. Ministers act on the views of chief executives about the quality of the advice supplied and management in a department. Ministers are also influenced by the views of chief executives on the commitment of their departments to ministerial and government priorities and how much they should take particular senior officials into their confidence. If ministers have concerns about departmental performance, they have many avenues for initiating corrective action.

With this degree of control, and the underlying constitutional conventions, the ultimate accountability for performance lies with the minister. As Palmer and Palmer note:

... a minister must articulate the policies being followed and defend them. He or she is supposed to see that the department functions efficiently. The chief executive of the department is answerable to the minister for this.¹¹²

The situation today is very different from the early 1980s, when it was common for ministers to front for their departments over internal management matters and defend them from attack without hesitation. The change to a higher profile for chief executives reflects the responsibilities they have under the State Sector Act 1988 for personnel decisions.

Palmer and Palmer emphasise that the reforms have not changed the underlying constitutional relationships since the early 1980s but that they have made them more transparent. As they put it:

... the way in which the state sector reforms have been implemented should not be allowed to obscure the constitutional truths that lie behind them and are unaltered by them. Among these, the doctrine of ministerial responsibility is the

¹¹¹ Palmer and Palmer, *op cit*, p 72.

¹¹² Palmer and Palmer, *loc cit*.

key fundamental. The reforms give effect to the traditional constitutional relationships between parliament, ministers, and the public service, but do so more transparently than in the past.

It seems to me, however, that while the doctrine of ministerial responsibility may not have been eroded in respect of ultimate accountability, the situation today is different in a practical sense. Chief executives are now much more accountable for the delivery by their departments of specified services, and they can face severance or non-renewal of contract on performance grounds alone. This is very different from the past, where performance was neither specified nor measured, tenure was permanent and only gross and obvious failure was punished.

The old pattern of relationships between ministers and chief executives has changed as a result of the depth of delegated authority to chief executives, with more public exposure of the affairs of their departments.

These qualitative changes have affected the doctrine of ministerial responsibility. Palmer and Palmer, quoting the 1962 Royal Commission of Inquiry on the State Services, have described this doctrine:

The essence of the doctrine of ministerial responsibility is that ministers are individually responsible to parliament for their own activities and the activities of their public servants in the administering of their ministerial portfolios. The employees of the department are the minister's agents; everything they do is in his or her name. In the eyes of the law, the permanent official is an anonymous instrument of the minister.¹¹³

It is not straightforward to capture today's reality in simple words. Chief executives, while still determinedly non-political, are neither as subservient nor as invisible as the words of Palmer and Palmer intimate. The case studies below show a different picture. The words of Palmer and Palmer also do not capture accurately the behaviour of some of the prominent senior civil servants, both in the past and recently, whose legacies are better remembered than even the names of the ministers they served. Perhaps the formal relationships always have been a default to which ministers and chief executives turn when the going gets tough.

Actions on the grounds of personal behaviour

Two cases illustrate the implications of chief executives being involved in criminal allegations. The former auditor-general, Jeff Chapman, left office

¹¹³ Palmer and Palmer, *op cit*, p 71.

before being convicted of fraud. The head of the Accident Rehabilitation Compensation and Insurance Corporation, Gavin Robins, left his post amid allegations of misappropriating funds. He was charged but was acquitted in court. These cases establish simply that a chief executive in these circumstances is expected to leave or to be severed long before the alleged crime is heard in court, but is subject, obviously, to the rights of employees under the labour and general laws. There are difficulties for boards and staff in an organisation whose chief executive is alleged to be acting illegally or unethically. As soon as suspicions are aroused, the board and subordinate staff find themselves in an awkward situation as a relationship based on trust erodes.

In the case of the former auditor-general, it appears that senior staff confronted the situation and brought it to a head, which demonstrated the strength of the internal culture and the commitment by staff to the values and ethics of the department. It is a difficult situation when a staff member becomes convinced that the chief executive is behaving illegally or highly improperly. A senior staff member confronted with clear evidence really has no option but to act and, indeed, runs a risk of censure later if they have not acted promptly.

There is no such difficulty for a board of a Crown entity, however, which can be expected to act immediately and has a range of possible responses to the improper behaviour of a chief executive. As soon as there is less than complete trust between a board and a chief executive, the board should consider the range of options available to it, depending of course on the seriousness of the situation. The board's options range from dismissal of the chief executive to negotiated severance. Despite having clear options, boards can be slow to act. It is common in these situations, in the public and private sectors, for the board to acknowledge privately that there were signs of difficulty in hindsight and that they did not act soon enough.

Breaching organisational values

The responses expected of senior staff when a chief executive is acting wrongly are clear when the concern is over illegal behaviour. Senior staff have a duty to report the behaviour to the SSC or the auditor-general if the evidence is reasonably clear. It is much more difficult to decide what a senior person should do when there is widespread concern in a department that the chief executive is acting outside agreed values and principles and is thereby undermining the department's internal culture and external reputation. In a well-functioning management culture, the issues would be addressed within

the top management forum or by individual approaches to the chief executive.

One of the hard implications of the philosophy of values-based organisations, which is spreading through the public and private sectors, is that senior personnel are as subject to correction over lapses from agreed values as other staff. In such organisations, it is accepted that staff will point out lapses by senior management. They can do so without any need to fear negative responses that affect them personally, if the manner of the exposure of the problem is, itself, within the agreed values and processes of the organisation.

The top management of an organisation that is making the transition from bureaucratic control to values-based empowerment of staff will always face some uncomfortable situations as their own behaviour is exposed in the same light as the behaviour of everyone else. This is a routine part of a healthy process of organisational improvement. If a point is reached where the behaviour of top management, and the chief executive in particular, are corroding the values base of the organisation, either the chief executive goes or the desired culture goes. If the values of the organisation are the right ones for promoting good performance and have been endorsed by staff, and by the board where there is one, then the chief executive has to leave in these circumstances and can expect to lose the loyalty of senior staff. This means that the SSC has a responsibility to monitor adherence to public-service-wide values. It may also need to make hard judgements on the appropriateness of, and conformity with, the more specific organisational values of individual organisations.

STRONG DISAPPROVAL BY A MINISTER OF A CHIEF EXECUTIVE'S DECISION

The accountability of a chief executive who has exercised proper authority but whose decisions have seriously angered ministers raises a situation that defines another of the hard edges of accountability.

In 1995, the chief executive of the Department of Internal Affairs, Perry Cameron, made an appointment to the head of the Civil Defence Services. That person, Frank Sharp, had left the military under a cloud caused by excessive spending on the refurbishment of the Airforce base commander's house at Ohakea. The appointment was within Cameron's legal authorities. His view was that Sharp was qualified for the job and had already been sanctioned for the actions he took. The minister of civil defence, the Hon

Warren Cooper, who was also the minister of defence, strenuously disagreed with this appointment and made strong public statements to that effect.

The chief executive resigned on the grounds that he had every right to make the decision concerning the appointment, but as it had led to a breakdown in his relationship with the minister he felt it was his duty to resign.

Mr Cameron's actions in doing so can be judged as the right thing to do, in that he made his decision in observance of two fundamentally important principles. First, that he would not yield to political influence to reverse the decision he had made and which was his alone to make. Secondly, that his relationship with his minister had been damaged seriously regardless of the specifics of the issue at hand.

This incident illustrates some further points. The decision over the appointment was a matter for Cameron's discretion. It presumably required weighing together the normal principles of an appointment on merit, the public credibility of the individual, in so far as it would affect his ability to do the job, and the fact that Sharp had, in a sense, paid his dues. This would have been a complex calculation. The decision to appoint Mr Sharp was one that many people regarded as unwise. Chief executives, however, are always making complex judgements and at some point all will make decisions that others, and even they, might subsequently think unwise.

The consequences of most wrong decisions are balanced up in an overall assessment of performance in due course. Most chief executives, on occasion, irritate their ministers seriously and do not have to resign. Considering the obligation to provide free and frank advice, it can be expected that all chief executives who take this obligation seriously will irritate their ministers on occasions. In the Cameron case, however, the political reaction to the appointment decision propelled the chief executive out of the normal give-and-take in a working relationship with a minister and into the political arena. This was partly due to the minister's explosive reaction, but even with a mild mannered minister, the decision would have caused political trouble.

It would be a mistake, however, to conclude that chief executives should never contemplate a decision that will upset their minister and lead to difficult political consequences. Even the most seasoned and highly competent chief executives have a few such decisions on their records. Rather, when a decision is being contemplated that will have political ramifications, it is good practice if the chief executive informs the minister in advance and considers the response to ensure there are no surprises.

CONSULTATION ON PERSONNEL DECISIONS

A question that the Cameron case posed is whether the general rule of 'no surprises' and of consultation before a controversial decision is made applies to personnel decisions. Although it is a delicate issue in terms of the State Sector Act 1988, this process should occur over a senior appointment where it is likely to have substantial political consequences. The decision, however, remains the chief executive's, in conformity with their rights and obligations of independence in personnel matters.

In effect this means that the minister is being consulted as the 'client' to whom the department's services will be delivered and for the management of which the minister is ultimately accountable. The minister will have to rely on the appointee to conduct their responsibilities to a high standard. The chief executive is, however, directly responsible for the performance of the department with deep delegations of authority and must therefore have full freedom to make appointments. While the minister may be consulted about an appointment, they should never be in the position of being party to an appointment below the level of chief executive, thereby making the minister partly responsible for the subsequent performance of the department and blurring the chief executive's accountability. What this means in effect is that the chief executive might think twice if the minister had a strong adverse view of the appointee, particularly if it was for legitimate reasons about which the chief executive was unaware.

Of great importance also is the principle of the non-political appointment process that ensures the availability of top quality professional and management staff. This principle is an essential element to maintaining public confidence in the impartiality of the administration of government policies. The non-political focus should be the chief executive's main concern when considering the appointment of senior staff, although the minister could also reasonably expect to be consulted over the appointment process.

In the Cameron case, the minister's statements were at variance with the requirements of the State Sector Act 1988. That Act is clear in stating that the responsibility for appointments lies with the chief executive of the department and that it is illegal for anyone, including a minister, to interfere in the exercise of those authorities. The Cameron case, however, needs to be interpreted in the light of the remarks above.

FUNDAMENTAL BREAKDOWNS IN RELATIONSHIPS

The Cameron case was complicated further, because it appeared that the relationship between the chief executive and the minister was deteriorating before the incident, which may, in the minister's mind, have been the last straw. If so, this indicates inadequacies in the processes of performance specification and review that preceded the Cameron incident. While there is always going to be some issue that triggers considerations of whether or not a fundamental relationship breakdown has arisen, it is desirable that, once having reached this point, the minister–chief executive relationship is addressed rapidly and not left until a serious incident arises.

In the event of a fundamental breakdown in the relationship between a minister and a chief executive, it is the chief executive who must resign and not the minister, unless the prime minister takes the contrary view. The employment contracts for chief executives provide for the removal of a chief executive if there is a fundamental breakdown in the relationship with the minister. The chief executive can be offered another position in the public service of equal status or severance arrangements can be made. This removal provision was introduced following at least one experience where a relationship had broken down, but the breakdown was not regarded as being due to proven poor performance on the part of the chief executive.

Another possibility in the event of a relationship breakdown is that the prime minister moves the minister in question to oversee a different department. In circumstances where a minister was clearly responsible for the breakdown and a competent chief executive had done everything possible to maintain an effective working relationship, the facts would inevitably be well known to the prime minister. It should be seen as a principle of natural justice that the state services commissioner should ensure that a situation such as that described above was known to the prime minister prior to taking action to shift the chief executive to another position or to negotiate their severance. An interview with Sir Robin Butler, former head of the Cabinet Office in the British government, indicates that such discussions between the head of the Cabinet Office and the prime minister do occur in the UK government. It is not known whether they have occurred in the New Zealand government in recent years, but it is safe to assume that they do occur. If they do not, then they should.

A change of minister after the 1996 election provided a further incident concerning lack of confidence by a minister in a chief executive. The new minister of conservation, Nick Smith, had disagreed with the outcome of the

process of consideration of the Cave Creek disaster, which is detailed below. He stated publicly that he did not want to work with the chief executive of the department. Should he have done this?

The provisions for dealing with a fundamental breakdown between a minister and a chief executive would degenerate into overt or covert politicisation of senior positions if incoming ministers can dispose of executives at their whim, however justified they may feel. Ministers can get rid of chief executives but the conditions for this safety valve must be clear and adhered to closely to avoid creating damaging incentives and uncertainty. A newly appointed minister is expected to work with a chief executive in good faith over a reasonable period of time before concluding that they can not work together effectively. It is very common for incoming ministers to have negative views about a department and its chief, only to find that within months a wholly satisfactory working relationship has developed. Senior executives working diligently but not politically for ministers can easily be poorly regarded by the political opponents of those ministers, even though they scarcely know them and have little knowledge of their actual capabilities on the job.

The circumstances and controversy surrounding the Cave Creek case placed the incoming minister in a position where he could scarcely avoid having a public view on the matter. But, if he had concerns that either the enquiries had been poorly conducted, or had been conducted under the wrong terms of reference, he had the power as minister to start fresh enquiries. If he was not concerned about those enquiries then he should have accepted the outcomes of them as had the ministers in charge at the time, at least publicly. If the minister thought the chief executive should have resigned then he was entitled to say so to the individual concerned and to the state services commissioner, the minister of state services and the prime minister. To go public as he did is contrary to accepted notions of good employment practice.

The question of whether the employment relationship should be severed is, under the law, a matter between the chief executive and the state services commissioner. The views of an incoming minister would be something both would take into account. The state services commissioner would be entitled to form a judgement that, in the circumstances, a severance was appropriate on the grounds that the disapproval of the new minister was so severe that a period of working together would not be likely to remove the minister's lack of confidence. In that case, the terms of that severance would reflect the

views that the commissioner had already formed regarding the chief executive's responsibility in the matter.

The outcome may have been the same in the Cave Creek case if the proper lines of authority had been fully respected. This would have contributed to the longer-term credibility and stability of those lines of authority. The manner in which the minister handled the situation is best regarded as a one-off situation in extraordinary circumstances, otherwise it has created a dangerous precedent.

More troubling, however, is the statement by the minister of state services, Hon Trevor Mallard, in 2000 that he wants the law changed so that it is easier to dismiss chief executives without severance payments. He also stated that:

There's been some discussions around the question of how easy or hard it is to get rid of some due to non-performance, or if there's a general 'face doesn't fit' situation.¹¹⁴

These are comments from an interview rather than considered government policy, but the concepts can be taken as raising the spectre of chief executives being dismissed without compensation, because their faces do not fit. This would simply be the end of the non-political public service and would have devastating effects on the recruitment and retention of senior staff.

The chief executives' contracts make it clear that they can be dismissed for non-performance. One reason why it has been difficult to sever contracts in a few cases has been that ministers and central agencies did not define performance clearly in the chief executive's performance agreement and elsewhere in the first place. The chief executives were able to argue that had they done what was expected of them even though ministers and their peers in the public service were unsatisfied with their performance. Another reason why it has been difficult to sever contracts is because of the decisions of the Employment Court, which have implied more protection of the executives than the State Sector Act 1988 intended. The new government should attend to both these sources of the problem that it is concerned about.

The question of severance payments to chief executives should also be addressed. Severance payments are coming about because the employing authorities and ministers do not always make adequate preparations when initiating a severance and they are forced to negotiate a payment to persuade the chief executive to leave. In reality there is often an element of ambiguity over a performance dispute. This ambiguity leaves the employer in the position of guessing the likely outcome if the employee takes a case to the

¹¹⁴ *Sunday Star-Times*, 6 February, 2000, p A2.

Employment Court and of calculating an offer that is cheaper and quicker to settle outside the Employment Court.

Mallard confirmed his perception of the issue in a further interview in which he complained of the head of a government department who he believes is incompetent but who cannot be dismissed without a massive golden handshake.¹¹⁵ Mallard said he wanted to change the law to allow chief executives to be dismissed when that was justified, without them getting golden handshakes.

At present, if the individual chief executive has failed to meet specified performance goals and this failure has been pointed out by the SSC, then the individual can be dismissed without a change in the law. The incoming government may think that the person is incompetent but cannot dismiss them if this alleged failure has not been brought to the chief executive's attention in a timely and responsible way. A new government cannot dismiss the person if the previous government and the SSC have indicated satisfaction with the person's performance. The obligation on the SSC to be a good employer prohibits it from dismissal over performance without prior notification of its earlier dissatisfaction. If there is ambiguity over whether performance is satisfactory, or the new government simply has a different view of the individual, then it is appropriate that a negotiated severance payment is made. The courts would generally support this as the person's career is being damaged by the action.

The information about the problems that the SSC has had dismissing people cannot be reviewed externally as it is confidential. The only grounds for changing the law, rather than tuning up the performance management system, would be that there is some legal impediment to implementing the intention of the State Sector Act 1988. For example, this might be that the tests of evidence of poor performance in the Employment Court are too favourable to the employee. A thorough examination of the history of attempted dismissals should be made public, while protecting personal information, before any legislative change is made.

The political issue in question is that the public does not like to see inefficient executives being paid out. The solution lies in addressing the two issues discussed, not in arbitrary and unfair dismissal.

The expansion in the law of the provisions for handling a fundamental breakdown in relationship between ministers and chief executives to

¹¹⁵ *The Dominion*, 7 February, 2000, p 3.

permitting dismissal over a poorly fitting face would be catastrophic and I would be very surprised if it is given any serious consideration.

Historical note

Dr William Sutch, who was appointed as secretary to the Department of Industries and Commerce in 1958, pursued vigorously policies of industrial development based on the insulation of New Zealand industry from international competition. He was very prominent in the eye of the public and was strongly and personally identified with the policies. When Sir John Marshall became minister of industry in 1965 he disagreed with Sutch's views. The government did not have confidence in him in that position and Sutch was dismissed.

Reactions at the time are interesting to reflect on. The PSA issued a statement that saw the dismissal as a threat to every public servant whose advice or decisions might be unacceptable to the political party in power and a threat to the integrity and impartiality of public administration. A respected contemporary of Sutch, John Robson, made a statement years later following Sutch's death that remains of interest today in thinking about public servants who push the outside of the envelope by being very prominent and vigorous in pressing their views on the government.

It is unreal to suggest that senior civil servants should behave like a group of palace eunuchs, but if they choose to be identified in the public mind with a point of view then they cannot expect to escape the consequences of such a view. This means that a permanent head who is advocating radical changes in policy will almost inevitably be sailing close to the rocks. Accordingly there has to be a careful regard for the climate of opinion and the prudent administrator will take soundings from time to time. Sutch had no wish to be a martyr but he did not seem to hear the raging storm until it was too late.¹¹⁶

The introduction of the five-year term in the State Sector Act 1988 and the subsequent 'no-fault severance' provision means that the same outcome would probably occur today in the same circumstances, but with less fanfare. If the cabinet did not have confidence in a chief executive when their contract renewal came before cabinet, they would turn it down.

It is interesting to reflect on whether senior civil servants are more or less exposed today to contract termination by cabinets that do not agree with their views. The election of a left-wing government in 1999 is providing an

¹¹⁶ Jim Anderton, *Unsung Heroes: Portraits of inspiring New Zealanders*, Random House, New Zealand, 1999, p 64.

interesting test. Party ideologists speak quite openly about wanting to remove the 'Treasury influence' from the public service. As noted elsewhere, the present treasurer said before the election that the government might have difficulty with some named chief executives who happen to have been former Treasury officers before being promoted to their present positions. These individuals won those positions in competitive appointment processes by appointment panels who, if they had a view about the suitability of a Treasury background at all, would probably have leaned in the direction of not favouring the appointment. These people won their positions on their merits. The SSC should have spoken out on this occasion in the defence of these individuals.

It is an interesting footnote that the PSA, which was so vigorous in its defence of William Sutch, did not speak up on this later occasion. One might conclude that there is a degree of preference for certain policy positions in the decision making by the PSA as to when to defend a senior civil servant with the argument that it used in the case of Dr William Sutch.

CAVE CREEK: IMPLICATIONS FOR ACCOUNTABILITY PRINCIPLES

For readers unfamiliar with the Cave Creek case, a viewing platform, under the responsibility of the Department of Conservation, which was cantilevered over a cliff, collapsed on 28 April, 1995, killing 14 people. The platform had been wrongly constructed, and in particular some bolts were missing from key points. The construction of the platform was in violation of building regulations. A number of points emerged from the case, which bear on the issues of roles and accountabilities between ministers and chief executives. Two enquiries were held. One was into the causes of the collapse¹¹⁷ and one into the management of the Department of Conservation.¹¹⁸

The process that followed the incident, and the outcomes from this process, did not gain sufficient credibility with the public for the government's response to be seen to be an end to the matter. There was a sense that the response by the government did not balance the loss of life that had occurred. This was an important lesson.

¹¹⁷ Report of the *Commission of Inquiry into the Collapse of a Viewing Platform at Cave Creek Near Punakaiki on the West Coast*, Department of Internal Affairs, Wellington, 1995.

¹¹⁸ State Services Commission, *Review of the Department of Conservation: Under Section 6B of the State Sector Act 1988*, Wellington, 1995.

Three years after the disaster some of the families of the dead still did not think that matters were resolved, and they believed that there should be an investigation into whether criminal negligence contributed to the collapse.¹¹⁹ This investigation came after the payment of \$2.6 million to the families, despite New Zealand's no-fault accident compensation arrangements.

Commission of inquiry

The report of the Commission of Inquiry into Cave Creek drew conclusions from the evidence presented to it in a way that added greatly to the confusion around the report's implications for public management and accountability. The ambiguity of the report is a likely reason why the eventual resignations of the minister of conservation and the chief executive of the Department of Conservation were not clearly linked to their connections with the actual events.

The report is clear in the account it gives of the events leading to the collapse and how the actions and non-actions of participants to the construction of the platform caused it to be unsafe. According to one critic, however, the inquiry overlooked significant evidence.¹²⁰ In judging the accountability of the parties involved in the construction and maintenance of the platform, the report weighed their actions carefully in relation to the relevant laws and considered what could be expected of people in real life management situations, rather than judging them against academic and unrealistic norms.

From the perspectives on public management in this book, however, the ultimate conclusions reached in the report are unsatisfactory. The story told through the report seemed headed for clear conclusions about non-performance of duties that were central to the Department of Conservation's mandate. The report did not reach such conclusions, however. Everyone directly involved in the construction of the platform was excused as either having acted in ignorance, or having done things they were not qualified or trained to do. However, ignorance of the law is generally not a defence. Also, some of the omissions in the construction of the platform would violate the common sense of the average home handyperson, such as failing to recognise that fastenings that might be sufficient for a structure that is fully

¹¹⁹ *The Dominion*, 29 April, 1998.

¹²⁰ Graeme Hunt, *Scandal at Cave Creek: A Shocking Failure in Public Accountability*, Waddington Publications Ltd, in association with *National Business Review*, Auckland, August 1996.

supported would be unsuitable for a structure nearly half of which is unsupported and cantilevered over a cliff. Was that not a failure in personal responsibility? Maybe so – but the judge chose to emphasise the lack of management that led to these people being uninformed of legal requirements and untrained for the tasks they undertook:¹²¹

The department did not act in a competent and appropriate manner. Nor did its nominated staff members, but all the while were working within a system that was fatally flawed.¹²²

Fair enough perhaps, but under this interpretation of events the higher levels of management must then surely be responsible for these shortcomings:

... no proper or appropriate system of control had ever been designed at head office level, and properly put in place and monitored at regional conservancy and thence at field level, to ensure that the procedures were followed ... head office ought to have laid down a specific process for distribution to regional offices. Without that, Mr Watson, and Messrs Wilde and Bainbridge, lacked the necessary skills (against the background of a completely new culture in which a government department has to be regulated by a territorial authority for particular purposes) to see that field centre managers were properly instructed and appropriate procedures put in place. And so it went up the chain of command.¹²³

But the report does not try to allocate accountability at points up the chain of command. It blames 'substantial systemic failure' for the absence of a project management system, which explains every one of the secondary causes¹²⁴ of the collapse. The report says, however, that it was pointless to try to find out why there was no system and does not even try to say who was responsible for this lack on the basis of conventional management practice:

... just who was responsible for the department's lack of a proper project management system is conjectural ... no satisfactory explanation is ever likely to emerge. Common sense suggests that it would be extraordinarily difficult to pin

¹²¹ Report of the *Commission of Inquiry, op cit*. See for example pp 36 to 40. See also, p 88 for evidence that the Building Act 1991 places the responsibility on the owner of the property to ensure those responsible for building a structure are appropriately qualified.

¹²² Report of the *Commission of Inquiry, op cit*, p 86.

¹²³ Report of the *Commission of Inquiry, op cit*, p 74 and p 75.

¹²⁴ The report describes these in chapter five as: failure to provide qualified engineering input into the design and approval of the project; failure to manage the construction adequately; failure to comply with statutory requirements; lack of inspections; systemic failure.

down precisely why a particular system was not instituted in a government department when it was reformed nine years ago.¹²⁵

In the absence of evidence that the chief executive of the department had taken reasonable steps to delegate this responsibility to a competent manager, then the buck stops with the chief executive. There is an oblique statement that the judge might have added the chief executive to a list of people who might be considered to be in breach of duties under the Crimes Act 1961.¹²⁶ The judge finds, however, that although the department was negligent and acted unlawfully, the named individuals did not. The summary of evidence stops with people below top management. The quote above exonerates top management.

On the issue of funding, the report contradicts itself. It states clearly that money was not the cause:

... the issue of adequate funding for this project ... was never in doubt ...¹²⁷

continues:

If funds were not available it could have been deferred (as it had been the previous year). No reduction in funding was imposed so no economies should have been made in the design and construction.¹²⁸

A bag of bolts was actually purchased and taken to the site, but not used.¹²⁹ The resources required were modest and entirely under the control of department managers in their internal budget allocation. It was not an externally imposed requirement.

The judge undermined the whole logic of these points with the qualifying comment:

Nevertheless I find that it was conceived and built within a culture developed to do more with less.¹³⁰

This ran against the evidence and shifted much accountability to whoever was responsible for this organisational culture, which has pervaded the entire public sector for many years and is likely to remain. What implications

¹²⁵ Report of the *Commission of Inquiry, op cit*, p 86.

¹²⁶ Report of the *Commission of Inquiry, op cit*, p 83.

¹²⁷ Report of the *Commission of Inquiry, op cit*, p 37.

¹²⁸ Report of the *Commission of Inquiry, op cit*, p 74.

¹²⁹ Report of the *Commission of Inquiry, op cit*, p 40.

¹³⁰ Report of the *Commission of Inquiry, op cit*, p 74.

does this have for public sector accountability across the board? In the epilogue the report hammers the point:

No government organisation can do its job without adequate resourcing. In my opinion, it is up to governments to ensure that departments charged with carrying out statutory functions for the benefit of the community are provided with sufficient resources to enable them to do so. Here, the evidence is clear that the Department of Conservation lacked and continues to lack those resources. For future safety that must change.¹³¹

This statement places the blame for unsafe structures with the government for funding the department inadequately and clearly reduces the accountability of the staff and management of the Department of Conservation for the collapse. The budget had been very tight since the department was founded, but whatever the merit of the point, the report's connections between this observation and the causes of the collapse are tenuous. It does not explain why the department had no project management system, the lack of which, it concluded, was the cause for the accident. A tight budget should act as a stimulus for strong project controls.

The judge also took seriously an argument that the Public Finance Act 1989 has created a focus on financial goals not outcomes, thereby blurring accountability.¹³² The implication was that the department had incentives to produce the output, the platform, with no concern for its effect on the safety and enjoyment of the people who used it. There was no evidence that the staff in question were subjected to any such incentives or indeed felt that way themselves. The evidence and the judge's conclusion were that the people were well-intentioned, horrified by the event, and caused it only out of ignorance of the requirements of their jobs or poor management from above. It is remarkable that no significant evidence was reported from government agencies responsible for public sector management to reach a well-considered opinion on this matter. There is a debate about the relative emphasis on outputs and outcomes in public management that is laid out in chapter seven. The treatment of the issue in the Report of the Commission of Inquiry is trivial and adds to the problems it creates about accountability.

The overall effect is that the report punts the responsibility for the tragedy into thin air. As a consequence, no one is accountable even though the judge notes a vagueness concerning accountability:

¹³¹ Report of the *Commission of Inquiry*, *op cit*, p 159.

¹³² Report of the *Commission of Inquiry*, *op cit*, p 76.

... very capable people from the top levels of the department's hierarchy simply did not seem to appreciate the concept of accountability in personal terms as it applies, for example, to the private sector ... but in this part of the New Zealand public sector I am left with the uneasy impression that the understanding of accountability is blurred.¹³³

The judge blurred the issue of accountability even further. The quote above can be taken to imply that he thought the top management should have taken the accountability for the failure personally in a manner similar to what he goes on to describe as private sector practice, essentially by losing their jobs. On the preceding page, however, he says:

... no individual or particular collection of individuals was singly or jointly responsible for the Cave Creek tragedy. The root causes of the collapse lie in a combined systemic failure against the background of an under-funded and under-resourced department ... the tragedy represents a symptom of the present conservation dilemma.¹³⁴

On the basis of this report it is easy to understand why the individuals concerned would not see the accountability as theirs alone. They were not responsible for under-funding, a culture of doing more with less, or the present conservation dilemma, whatever that might mean.

As I read the evidence that was presented in the submissions, there is enough there to form a judgement about accountability by reference to reasonably well-accepted principles of governance and public management. The questions of financial and staff resources are conclusively disposed of. There is sufficient evidence to address the question of who had responsibility for ensuring the department's knowledge of, and compliance with, the building code and whether this duty was discharged. There is evidence of who was responsible for the installation of the platform and for being satisfied that staff had carried out work satisfactorily. The evidence addresses the question of whether a competent manager needs a procedure to tell them that they should follow up to ensure a direction to staff has been carried out adequately or whether it is the essence of the manager's responsibilities. There is evidence given in the report on what a chief executive is entitled to expect from staff and under what provisos.

All this should have been enough.

I am not arguing here that systemic failure should not have been addressed. This can be an important cause of catastrophe as it was in the

¹³³ Report of the *Commission of Inquiry*, *op cit*, p 75.

¹³⁴ *Ibid*, p 74.

explosion of the US space shuttle. But this failure cannot substitute for conclusions about specifics. Also I agree with the submission that argued that the commission should have reconvened to consider the question of accountability for systemic failure if it was giving substantial weight to the cause. Systems do not materialise out of thin air, but are the responsibility of the people who design and implement them.

This could have been a precedent-setting case about how accountability in the public sector measures up against the background of statute, public law and common law. New Zealand also has a long tradition of formal and informal rules and conventions about how the public service runs itself, and these should also have been given weight by the judge. Private sector practice could also have been used, with appropriate qualifications, to reach a clear conclusion. The opportunity was lost and the suffering of the relatives of the dead increased.

One lesson from the Cave Creek situation is that if the government wants the terms of reference of an inquiry to include matters of public management, finance and accountability, then the inquiry should include people who are experienced in these matters.

In the circumstances, the findings effectively put the blame on to the minister of conservation, because he was responsible for the issues that the judge gave such weight to. Eventually the minister conceded this in effect by resigning, even though the prime minister had advised him earlier not to. Later in his memoirs, the prime minister said this advice was wrong.¹³⁵ He concluded that a resignation would have eased the grief of those seeking an explanation and for someone to be seen to be responsible. The subsequent decision by the chief executive of the department to resign was also personal. The personal pressures these men are known to have endured were terrible. The symbolism of these resignations was significant and must have provided some small solace to the bereaved. However, the meaning of these resignations in terms of principles and practices of public sector accountability remains unclear because of inadequacies in the report of the Commission of Inquiry.

The report does not draw a clear conclusion about whether the chief executive, Bill Mansfield, had acted in accordance with accepted practices of good management in assigning responsibilities and resources to staff and monitoring their progress. If he did then the accountability moves to the

¹³⁵ Jim Bolger, *Bolger A View From the Top: My seven years as Prime Minister*, Viking, Auckland, 1998, p 252.

senior subordinate to whom he allocated the responsibility where the same test applies again. At some point or points in the chain of command either the management framework under which a person operated was flawed or that person exercised discretion incompetently. Questions of the organisational culture and wider circumstances of the Department of Conservation would be relevant to a balanced judgement about the cause of the accident but not to the whole basis of the conclusions drawn in the report.

State Services Commission review

In December 1995 the SSC conducted a separate review¹³⁶ of the performance of the Department of Conservation and its chief executive under section 6(b) of the State Sector Act 1988 in respect to the matters arising from the report of the Commission of Inquiry into Cave Creek. The terms of reference listed seven specific matters. The key findings were that:

- reporting against identified risks was generally adequate but no systematic framework existed to ensure a consistent approach to risk analysis across the department or that all potential risks are considered;
- systems and controls, management practices and performance were generally of a good standard but varied widely across the department;
- the organisational health of the part of the department responsible for the platform was low;
- the internal audit function was not providing the chief executive with the assurance he needed that systems were operating effectively;
- head office made regional managers responsible for compliance with laws on buildings and safety but was not sufficiently proactive in ensuring consistent implementation;
- lack of funding did not cause the accident;
- subsequent attention to management systems made a repetition of the accident extremely unlikely; and
- the enquiry agreed with the SSC's assessment of the chief executive that he either exceeded or met the expectations of an able and competent public service chief executive.

The review's conclusions in regard to the performance of the Department of Conservation and the chief executive were:

¹³⁶ State Services Commission, *Review of the Department of Conservation*, Wellington, December 1995.

While there were weaknesses in the systems operating at the time of the tragedy, we believe that it was a combination of circumstances, misunderstandings, communications breakdowns and failure to follow procedures, but not a lack of funding, which resulted in conditions which made the disaster possible.

In respect of the overall management systems and controls in the Department of Conservation, we believe that while improvements in systems and management practices are always possible, in the experience of the Review Team the Department does not compare unfavourably with other departments and organisations taking into account the environment in which it has and continues to operate.

In concluding this review, the Review Team has been impressed by the difficulty of the job the Department's staff has to do and notes that, in general, they do it well.¹³⁷

The review exonerated the department from being blamed for generally poor management. The issue in the minds of the public, however, was surely not whether the department was generally well managed, which was already known, but whether it was badly managed in respect of the events leading up to this particular catastrophe and, if so, who was accountable for that. Like the Commission of Inquiry, this review did not squarely address this question.

In such circumstances the question of whether a chief executive should be sanctioned is not addressed by looking at the general record, but at whether the individual is in some way to be held to account for a particularly serious incident. This might be on the basis of vicarious accountability as the head of the organisation, rather than some specific culpability for inadequate management.

It should be rare for chief executives to take the rap over failures by subordinates who have been appointed for their competence and who have been delegated clear responsibilities and resources to do the job. Chief executives will take the rap, however, when the consequences of the situation are so serious as to demand accountability at the top level, regardless of the circumstances.

Any assignment of responsibility should be driven by the principles behind the State Sector Act 1988. A chief executive must perform well to stay employed and that judgement, while much influenced by the levels of satisfaction of ministers, is for the SSC to make.

This places a difficult burden on the SSC to make judgements about when a performance problem has broken out of the range of routine performance

¹³⁷ *Review of the Department of Conservation, op cit*, p 36.

management processes and needs to be addressed in terms of a serious specific incident. As a guide, the SSC should consider whether the department or the individual is unable to maintain the confidence of the public in general, not necessarily those who are immediately affected by what has gone wrong. In the aftermath of the Cave Creek incident, the SSC considered these issues in such terms.

The enigma of Cave Creek

The way the Cave Creek story came to an end is an enigma in terms of the roles and accountability issues of concern here. Both the minister and the chief executive ran the gauntlet of formal inquiries and informal pressures. Both resigned for personal reasons months later when the pressure on them appeared to have abated. Both had said previously that they wished to remain in order to address the problems of the Department of Conservation in terms of budgetary provisions and management issues. It can be fairly said that they achieved these objectives because more money was budgeted and substantial management changes were made.

The minister of conservation, Denis Marshall, said in his valedictory speech to parliament that resigning immediately would have been the soft option and that:

Cabinet would have accepted the sacrifice and DOC would never have got the \$60 million it needed to rebuild and go forward. Delaying my resignation until the job was done might not have been the smartest move politically for me, but was definitely worth the sacrifice in the name of conservation.¹³⁸

But what are we to take from the actions of the minister and the chief executive concerning principles and expectations about accountability?

It is unlikely that precedents will be accepted to the effect that one should remain in office to attend to serious difficulties pending an expected resignation, or that it should be a personal decision whether to continue in a role following a problem of this magnitude. There are, however, grounds for both these propositions in particular circumstances. The individuals might be uniquely qualified to address the problems. For example, a top manager from the Development Finance Corporation, Keith Sutton, was retained after it collapsed in 1989 to assist the statutory manager to sort out the winding up of the company. Also, where the circumstances are sufficiently ambiguous in terms of the application of any doctrines of accountability that are in place,

¹³⁸ *Evening Post*, 8 October, 1999.

the decision to leave or stay will rest with the individual by default. Some chief executives will be more inclined to tough it out than others would.

Neither of these circumstances appear to apply in the Department of Conservation case, going from comments the individuals made at the time. So the question remains, if the two resignations were the right thing to do when they occurred, why were they not the right thing to do earlier? Both men were troubled personally by the situation and apparently resigned of their own accord, but this leaves open the question of whether there should have been more principles and doctrines that determined earlier whether they should have gone or stayed. The comments by the state services commissioner when the chief executive resigned can be taken to imply that he favoured the decision, adding further to the questions of what principles were at issue.

The ultimate responsibility for the management systems within which staff operate rests with the chief executive. The enquiries following Cave Creek, however, did not conclude that the chief executive of the Department of Conservation had been directly negligent in a way that led to the disaster, and there were no criminal prosecutions.

So far as the minister of conservation was concerned, he was ultimately accountable politically for departmental management. The question really came down to whether, in the context of cabinet collective responsibility, the government as a whole felt that the minister's continued presence in the portfolio was a political liability. The cabinet apparently did feel that he was not or they would have said so when the heat was on immediately after the accident or after the report. Perhaps it could be seen clearly only with the passage of time that the public were not going to be satisfied with the minister's initial responses.

This leaves the question of vicarious accountability, which is extraordinarily hard to define. This type of accountability needs to be considered with great care in order to restrict the degree of arbitrariness that could occur. Unless vicarious accountability were restricted to isolated major problems, it would create incentives for senior public servants that were quite counter-productive to sound management practice, in that the chief executive might constantly intervene in operational decisions and disrupt overall departmental performance. The doctrine can only apply in very unusual circumstances or else chief executives would be continually vulnerable for things going wrong in their departments, notwithstanding the fact that they have properly delegated duties to competent people. There will always be things that go wrong, because government agencies are inhabited by human beings. But it should only be on rare occasions that a problem that the chief

executive did not in some way contribute to should overshadow that executive's general record of high performance and success.

Perhaps the resignation of the chief executive of the Department of Conservation did define the place where vicarious accountability is appropriate. He had a clean bill of health on the management of his department, but finally decided he did not want to continue, or, at least, could not. It seems that resignation or termination should probably have occurred earlier if it was to happen at all, unless his presence in the department was indispensable to see through the subsequent management changes. That would be an unusual occurrence but the major parties involved apparently thought that it applied in this case.

In extraordinary circumstances such as this, what is appropriate accountability depends on the particular circumstances and not only the application of preconceived principles. Such principles in this case were unclear, however, and the incident would have been less troubling if this had not been so. The circumstances are always likely to be extraordinary when the question of vicarious accountability arises. The quote below contains an eloquent statement of this principle of accountability by Lord Carrington in the circumstances of the Argentine invasion of the Falklands:

The general reason was my sympathetic understanding that the whole of our country felt angry and humiliated. I felt the same myself. British territory had, without warning, been invaded. There were hysterical outbursts in Parliament and yells of 'betrayal', and although these were inaccurate and offensive they were understandable. Inhabitants of a British colony – men and women of British blood – had been taken over against their will. Diplomacy had failed to avert this. Military reinforcement had not been tried. Deterrence had been exposed as a bluff. Our hand had apparently been called. There was never the slightest doubt that, with Margaret Thatcher at the head of the Government, we wouldn't take this lying down, and we didn't. But the first shock and fury were felt through Britain, and in those circumstances – with people very naturally turning on the Government and accusing it of mismanagement – it is right, in my judgement, that there must be a resignation. The nation feels that there has been a disgrace. Someone must have been to blame. The disgrace must be purged. The person to purge it should be the minister in charge. That was me. I was also very aware that my membership of the Lords was at that moment an embarrassment to the Prime Minister, and a weakness. In the Commons Humphrey Atkins was first-class, as was Richard Luce, but when there's a real political crisis it is in the House of Commons that the life and death of Government is decided and I bitterly regretted that I could not face the House at Margaret Thatcher's side.

The more particular reason was my awareness that the Government was in for a hard time and that my presence would make it not easier but harder. We were

now assembling a task force and sailing it to the South Atlantic – an action with which I heartily agreed. During the time it would take – a matter of weeks not days – it was going to be difficult to keep Parliament and country sufficiently united behind our actions, and unity is essential in war. My departure would put a stop to the search for scapegoats. It would serve the cause of unity and help turn the eyes of all from the past to the immediate future.¹³⁹

There is nothing confused or enigmatic about this resignation or the reasons for it. Perhaps the resignations that followed Cave Creek might have been easier for the men involved, and the messages they sent to the public more clear, if the enquiries had been more definitive about specific issues of accountability.

Cave Creek was a defining moment in public administration in New Zealand and its messages for the future need to be drawn out and codified with great care so that the government, ministers, chief executives and citizens are all aware of how responsibility will be allocated should there be another incident of this degree of seriousness. The subsequent work of the SSC on accountability took this consideration some way forward.

SOME POINTS OF COMPARISON WITH THE PRIVATE SECTOR

In the private sector, would an incident such as Cave Creek cause the chief executive or chairperson of the board to have to resign? The minister of conservation at the time of the Cave Creek case stated that public service chief executives are more accountable to the public than a private sector chief executive is to the shareholders. Some private sector people disputed this.

There are some differences between the strictly legal accountabilities of public service departments and their chief executives on the one hand and private sector companies and their directors on the other.

The obligations of directors under the Companies Act 1993, other statutory obligations and laws of negligence create possibilities of sufficient financial loss to private sector firms to lead the top management or shareholders to take action against the people who cause losses through negligence, unethical behaviour or incompetence. The Commission of Inquiry into the Cave Creek disaster highlighted that the Crown is exempt from prosecution under the Building Act 1991 and the Health and Safety in Employment Act 1992 and recommended that these exemptions be removed.

¹³⁹ Lord Carrington, *Reflect on things past: the Memoirs of Lord Carrington*, Collins, London, 1988.

Also, section 3(5) of the Resource Management Act 1991 provides that “no enforcement order, abatement notice, excessive noise direction, or information should be issued against the Crown”.

In 1998, the SSC and the attorney-general worked with the New Zealand Law Commission on the issue of making departments legally liable under the Occupational Health and Safety Service legislation and the Building Act 1991. The minister of conservation said at that time that he and his department supported this law change. On the basis of the evidence of the Cave Creek inquiries the outcome would have been different if this legal liability had applied at the time of the accident. In any legal proceeding, the question of whether an executive had been diligent and prudent in setting up management systems, in accordance with contemporary practices, would weigh heavily in the assessments.

In the years since the accident the government has not reached a conclusion on whether departments should be open to prosecution. Denis Marshall’s valedictory speech, however, included the following:

On reflection, government departments should be able to be prosecuted for failing to comply with the building code and the Occupational Health and Safety Act like anyone else.

He acknowledged the constitutional problem of the Crown prosecuting the Crown but said it was outweighed by the principle that government agencies should bear the same liabilities as anyone else. This law change would be desirable in my view. It would bring such issues within the ambit of normal legal proceedings and precedents. The outcomes would not be so dependent on the personal capabilities and orientations of the particular individuals who are appointed to commissions of inquiry or the opinions of the cabinet about appropriate compensation to victims.

Section 86 of the State Sector Act 1988 confers immunity from personal liability on chief executives, and other public servants, in respect of good faith acts and omissions in pursuance or intended pursuance of the functions or powers of the department or chief executives.

Removing Crown exemption from prosecutions is not as simple a matter as it may seem at first glance. The ancient doctrine, that the Sovereign is above the reach of the law, is obsolete. But there are public policy issues concerning the effects of applying full legal liability to the affairs of the Crown. The effective conduct of government may justify some differences from the private sector obligations. The protection of MPs from the reach of libel laws when they speak in the house is an obvious and increasingly controversial example. The activities of the defence forces are inherently

dangerous in some respects. Normal occupational safety laws would be unrealistic in battle conditions and would expose the taxpayer to unjustified risks. It can be argued that a lower standard of safety of structures maintained by the Department of Conservation than those required of normal building standards is justified. Take the example of the three-wire bridge that is not much more than three wires strung across a river with the intention that trampers stand on the lower wire and hold on to the other two with their hands. These bridges may be dangerous for inexperienced trampers, but it is probably safer to leave them in place than to have trampers wade through flooded rivers to reach shelter. Access to the bush is legally uninhibited, so bridges should be available on the understanding that they are used at the trampers' own risk, provided they are fit for the purpose for which they are intended. The Cave Creek platform was not. A greater degree of hazard should generally be accepted, however, for structures in the bush than in a factory or shopping mall.

There are well-established laws and conventions about the liability of directors of companies incorporated under the Companies Act 1993 that are relevant benchmarks for public sector accountability. However, they do not translate to the public sector. For example, section 137 of the Companies Act 1993 requires that:

A director of a company, when exercising powers or performing duties as a director must exercise the care, diligence, and skill that a reasonable director would exercise in the same circumstances taking into account, but without limitation:

- a the nature of the company
- b the nature of the decision, and
- c the position of the director and the nature of the responsibilities undertaken by him or her.

There is no comparable provision for the chief executives of government departments or directors of Crown entities, except for entities incorporated under the Companies Act 1993. The State Sector Act 1988 provides only limited protections, and this does not cover acts of bad faith.

As to the questions of diligence, there are interesting parallels with the provisions of the Companies Act 1993 as it applies to company directors. Section 138 of the Act allows a director, when exercising their powers or performing their duties, to rely on "reports, statements and financial data and other information prepared or supplied, and on professional or expert advice given" by:

- an employee of the company whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned;
- a professional adviser or expert in relation to matters that the director believes on reasonable grounds to be within the person's professional or expert competence; or
- any other director or committee of directors upon which the director did not serve, in relation to matters within the director's or committee's designated competence.

This is always subject to the proviso that any director who wishes to rely on these provisions must have acted in good faith and made proper inquiry, where the need for inquiry is indicated by the circumstances, and had no knowledge that such reliance is unwarranted.

This private sector provision has relevance as a possible guide to ministers and it also establishes principles that could guide a chief executive concerned to be prudent in relying on the advice of others.

TWO CASES OF PRIVATE SECTOR ACCOUNTABILITY

There are two relevant contemporary case studies in accountability in the private sector and in the grey area of community-owned organisations: Brierley Investments Limited and Mercury Energy.

Mercury Energy was responsible for the underground cables that failed and cut the power supply to the central business district of Auckland for weeks during the autumn of 1998. The chief executive of Mercury Energy, Wayne Gilbert, announced that:

If this is an issue I will be quite happy for the board of directors to replace me if they feel they need a scalp. It is a dark day for us; I don't seek to blame others. It is our issue and we need to fix it. We are extremely sorry and this is an enormous setback to our reputation. I am going to work hard to restore that reputation.¹⁴⁰

This reflects clearly the Cave Creek principle that a chief executive may have to resign on the grounds that the reputation of the company has been seriously hurt, even if it is not clear precisely who, if anyone, has acted carelessly or negligently in causing a failure. Following a government enquiry into the supply failure, Gilbert said:

¹⁴⁰ *Sunday Star-Times*, 22 February, 1998, p 1.

At the moment the reputation is as low as you can get and my personal reputation is somewhat below that. If the inquiry establishes there is blame attached, without a doubt you can expect my resignation.¹⁴¹

This statement links the question of his possible resignation to the outcome of an inquiry into the details of the cable failure. Such a statement was most unusual, although it reflected the reality of the situation. The incident was of such potentially grave consequences to the company's customers that if blame were fairly due to the company, then resignations from the board would be appropriate. The peculiar provision whereby the board of Mercury Energy itself largely controlled who was on it meant that the normal process of consideration by a shareholder's general meeting could not occur, leaving the onus on the board members to make such a performance judgement. Prior to the enquiry, board members and the chairman of Mercury Energy presented the incident as bad luck and due to events beyond their control.

Some of the main findings of the inquiry said otherwise:

- there were problems with the power cables when they were owned by Mercury Energy's predecessor, the Auckland Electric Power Board;
- Mercury Energy lacked expertise in operations and management procedures for the affected cables;
- Mercury Energy lacked quality control systems in the form of asset audit, asset management programmes, systematic investigations of cables, contingency planning and risk management;
- security of supply was under-planned; and
- corporate governance may have been compromised by the absence of clear board accountability through effective shareholder and/or market disciplines.

Sadly, the day before the report was due to be released in July 1998, Wayne Gilbert died and the electricity industry lost a widely respected leading figure. The company was subsequently restructured but the governance arrangements, which I believe were an important contributing factor, remained in flux for some time. They were a result of fatal compromises in the policy of reform of the retail electricity sector and were seriously flawed by reference to either public or private principles of good practice.

In the case of Brierley Investments Limited, a board member, Sir Roger Douglas, and the chairman of the board, Bob Matthew, were concerned about the performance of the company's share price and commissioned a

¹⁴¹ *Sunday Star-Times*, 1 March, 1998.

report that turned out to be critical of management. The chairman resigned and, by some reports, wanted the chief executive to do so as well. The chief executive commissioned another report and resisted the pressure to resign but was voted out by a board resolution.¹⁴² Some in the business community saw these events as shocking and surprising. In fact, they would appear to be the normal workings of the governance of a company whose share price had been in the doldrums for years. Also, there had been considerable dissatisfaction expressed by shareholders at meetings over excessive executive compensation and poor returns on shares. Usually, such things are done more discreetly.

There is evidence of unclear principles of accountability in the private sector and of slowness in applying them to poorly performing executives. In the Brierley case, the company had several executive directors, which made a fight between the internal and external board members inevitable. There is a substantial body of opinion internationally that believes that the functions of management and governance should be kept more separate than was the case for Brierley Investments Limited.

The quality of financial reporting and other matters of accountability have been seen to be poor in many companies in the late 1980s at least. The mechanisms of self-correction are different and sharper in the private sector because investors desert companies that are not properly accountable to their shareholders. This kind of threat should tend to bring the most efficient behaviours to the fore over time. The Brierley case shows, however, that the time can be long.

In response to the proposition by some business people that the private sector was more accountable, the SSC commissioned a report to study the matter and to summarise its conclusions on the standards expected of chief executives.¹⁴³ The main points were:

- accountability regimes in the two sectors are very different;
- public sector accountability is more complex because it concerns the functions and duties of the department, and cannot be measured in commercial terms;
- the private sector is more rigorous in addressing performance failures;

¹⁴² *Sunday Star-Times*, 3 May, 1998.

¹⁴³ State Services Commission, *Responsibility and Accountability: Standards Expected of Public Service Chief Executives – Key Document*, op cit, p 15.

- there is a wide spread of attitudes towards accountability in the private sector; and
- the concept of 'a duty of care' is relevant to both sectors.

There is value in continuing to compare accountability principles and practices in the private and public sectors because they have common underlying concepts. In doing this, accountability needs to be considered widely, and not simply as the way personal performance is addressed. It involves having:

- clear objectives, goals and plans;
- systems for reporting against these;
- a culture of responsibility and ownership for personal, team and organisational performance; and
- a culture that encourages appropriate responses to managing risks and taking and making opportunities.

THE INCREASING DEMANDS FOR ACCOUNTABILITY

The accountability mechanisms surrounding the public sector are many and varied. As well as the State Sector Act 1988 and Public Finance Act 1989, many public sector organisations have accountabilities set out in specific legislation. In addition, there are accountabilities under the Official Information Act 1982. Government organisations are subject to inquiries by the auditor-general and by select committees that are no longer under the thumb of the executive of the government. There is a variety of commissions with powers to recommend or impose requirements for accountability, such as the Human Rights Commission and the Privacy Commission. There are various ombudsmen who also have these powers. In addition, public and administrative law have developed rapidly. These laws impose heavy requirements on public institutions to consult before making decisions, and the courts can overturn these decisions. The courts are opening some avenues for citizens to sue the Crown, in some circumstances, by limiting the blanket protections that were previously thought to be in place.

Inside the executive arm of government there are elaborate formal systems for holding public officials and boards accountable for their performance in delivering services, managing their organisations and being responsive to their clients. The system of performance agreements for chief executives, statements of intent for Crown entities, statements of corporate intent for state-owned enterprises and the annual reports of all public

institutions all added an element of specificity and openness to the accountability systems that had no precedent and that are not common internationally.

A 1998 review by the SSC of the public sector accountability system noted the increasing demands on core government agencies.¹⁴⁴ These included:

- purchase agreement (Crown Law opinion);
- annual report (Public Finance Act 1989);
- chief executive performance agreement with key result areas (Cabinet Circular);
- department forecast report (Public Finance Act 1989);
- strategic business plans (SSC expectations);
- business plans for capital bids (Cabinet Circular);
- monthly financial reporting (Public Finance Act 1989).

Problems with the accountability documents included:

- complexity and duplication;
- information gaps – capability largely ignored, strategic alignment weak, core business under-emphasised and performance indicators for non-financial information weak;
- demotivation of chief executives through problems in the quality of monitoring and a focus on short-term objectives by some ministers.

These were seen as problems in how the accountability system operated, rather than fundamental flaws in the system itself. Clearly there is much that can be done to improve the framing and application of the accountability requirements in practice. According a more prominent role to the strategic business plan is one strong improvement option. This is discussed in chapter 11.

It is curious that, in parallel with this rapid development of accountability systems, the demand by the public for accountability seems louder, and in some respects more strident, than ever. What explains this? It could be because the citizens are not interested in the systems as such but in what happens in practice. Systems are sometimes seen to be failing and the responses to that failure inadequate. The incidents that come into public consciousness, such as deaths due to poor service in hospitals and

¹⁴⁴ State Services Commission, Occasional Paper No 10, *Improving Accountability: Setting the Scene*, Wellington, August 1999.

expenditures that are seen as inappropriate, dominate public opinion even though the accountability system as a whole has been improved. Is it the case that the more you know the more you will complain and demand to know? The Official Information Act 1982 caused a revolution in access to information about the public sector, so the public became much better informed about the standards and the range of performance operating in the public service.

Citizens have also become much more demanding consumers of public services. This is likely to have been engendered by the revolution in the private sector caused by the removal of protections for producers from competitive forces in the economy. We put up with queuing for over-priced cars that broke down because we did not know any better, just as we put up with queuing at the Post Office Savings Bank, for house mortgages. Another factor was the arrival of 'total quality management' (TQM) and other quality management techniques that drove companies to develop new values of service to their customers. In this environment, the long waits and low-quality service that citizens were accustomed to from all their public institutions looked increasingly unsatisfactory. There were new voices also arguing that it was unnecessary for public services to be of low quality.

With the public sector's failures less easily obscured or hidden, the public also reacted to the duck-shoving bureau-speak and political evasions surrounding performance failures in the public sector. Negative reactions to bureau-speak have been amplified by the appearance of public relations and media consultants through the public sector. The public's knowledge of them is usually restricted to the appearance of these consultants at times of performance failure and other difficulties, which creates the impression that the management system is covering something up.

The reality may be that the state of the public sector is no worse than before, but it seems reasonable to assert that the tradition of simple ministerial accountability for performance failures has faded, even though it was never as embedded as was commonly believed. Perceptions of ministerial accountability were driven more by the resignation of British cabinet ministers than New Zealand ones. When a rail tunnel collapsed in 1944, the minister of works, Bob Semple, famously declared that he was responsible but not to blame. The minister of works took too little responsibility for the failure in management of the Maniototo irrigation scheme in the early 1980s and there were numerous other examples of departures from the principle that ministers were politically accountable for

the acts of departmental managers, whether they knew anything about them or not.

In 2000, the minister of immigration, Lianne Dalziel, made a very strong statement that she was not prepared to support her department when it raided a house to remove illegal immigrants, which it was entitled to do under the law. She made much of the fact that she had been lied to because her officials had told her that the raid took place between 6.30 and 6.45 am when in fact it was between 6.05 and 6.10 am. This is a very long way from the tradition of ministerial accountability quoted in Palmer and Palmer above.

The public's demands for accountability, and the system's response to these, have emphasised the personal positions of the individuals in charge. Senior public servants are more visible today in the giving of speeches and interviews than they once were. The public has increasingly demanded that there be a face to a faceless bureaucracy and that an individual be personally accountable for the performance of the organisation that they manage. This has led to demands for greater accountability at senior management levels.

These wider trends in demands for accountability are parallel to what has gone on in the private sector, where the legal liabilities of company directors have been expanded to cover matters that they, personally, could not possibly be expected to know about. These are not just accountabilities back to their own shareholders, but accountabilities that are more widely spread, for example, in the area of environmental pollution.

Although the reasons for the demands for greater accountability seem plausible, there are other possibilities. It is arguable that the failure of the array of sophisticated accountability institutions to satisfy the growing demands for accountability means that the wrong approach has been taken or, at the very least, that something in the approach is missing. The systems are not dealing with accountability issues in a way that satisfies the demands for more accountability. Perhaps there is a general sense that the loss incurred by citizens affected by public sector management failures is not in balance with the public sector's response. Perhaps the accountability systems are creating expensive formal mechanisms that are not as effective as something simpler and possibly more effective. The legal protections for chief executives and process issues have led to lengthy formal approaches to performance management having to be taken. More informal and frequent feedback, coupled with the greater possibility of early severance for serious inadequacies, might have been more effective.

Although it may be that more protection is provided than is good for the public management system as a whole, there are other countervailing issues to consider. The provisions for personal accountability are only one aspect of a management system that seeks higher levels of performance and that must be in balance with the other elements if we are to avoid 'management by sacking people'. Superior policy formulation and performance specification, good information, effective monitoring, adequate resources, and effective behaviours by ministers and central agencies are just as important to overall performance as is the meeting of demands for stronger personal accountability. The issues of accountability need to be addressed by the SSC within this wider context.

Future governments must be careful to maintain a pragmatic balance between all the different pressures on the public sector on the basis of accepted concepts and principles. It would be highly dysfunctional if an accumulation of particular requirements and institutions of accountability led to an overall accountability framework that was neither principled nor pragmatic. This could easily happen over time, as ad hoc solutions are reached for in response to incidents of failure and special interests push for particular requirements for accountability. While ad hoc changes may be defended as pragmatic, it can be an illusion when, for example, the changes are uncoupled from a consideration of their systemic implications. The ultimate result of ad hoc decision making would be to the detriment of public sector performance.

ACCOUNTABILITY THROUGH THE CHIEF EXECUTIVE'S EMPLOYMENT CONTRACT

The channel for establishing and implementing accountability doctrines is through the chief executive's employment contract with the SSC, the surrounding legal requirements and the 'good employer' requirements on the SSC in dealing with chief executives.

The SSC appears, at times over the years, to have found it difficult to take action against chief executives considered to be poor performers. The views of the poorly performing chief executive's minister can be a problem. It is one thing for a minister to complain to the SSC about a chief executive's performance, but another to appear in the Employment Court and repeat the criticism if the chief executive takes a case there.

The SSC must also be concerned with the effects of any particular case on its wider obligations and reputation as an employer. A chief executive who refuses to accept the SSC's judgement of seriously poor performance and

threatens court action has had more chance of staying on in their role than was in mind at the time of the reforms, whereas a chief executive who accepts the judgement of the SSC leaves. This can be unfair. It creates an incentive for those in such circumstances to go to court rather than to resolve the matter within the employment relationship.

The State Sector Act 1988 places heavy requirements on the SSC to ensure that chief executives are competent to do their jobs, and that they are removed if they are not. Some poor performers have lingered too long. The SSC should review its processes for performance appraisal to ensure that they are robust. If the labour laws are inhibiting the SSC from doing its job, the government should be asked to look at the issue in the context of general employment law.

THE SSC REVIEW OF CHIEF EXECUTIVE ACCOUNTABILITIES AND RESPONSIBILITIES – THE ‘STANDARDS REPORT’

The SSC responded to the issues of accountability arising from Cave Creek and other experiences by codifying its principles and expectations in relation to such incidents. This code will assist but it needs to be considered within the total framework of the employment contract and employment law, which constrain the discretion of employers, even when performance expectations have been established with their employees.

The SSC conducted a review of accountability issues that was published in June 1997 (and is referred to as the ‘standards report’).¹⁴⁵ This publication concerns the standards expected of chief executives and contains:

- a ‘standards letter’ that is sent to each chief executive;
- attachments to this letter listing key guidance documents;
- a summary of some essential points on responsibility and accountability; and
- a report on the subject from the SSC to the minister of state services.

At the time this material was being developed, Don Hunn, the state services commissioner, referred to a public demand for resignation as a visible sanction for lapses in performance in some circumstances. He noted that chief executives were likely to be advised, in some non-binding way, of the kinds of circumstances in which they would be expected to tender their

¹⁴⁵ State Services Commission, *Responsibility and Accountability: Standards Expected of Public Service Chief Executives – Key Documents*, Wellington, June 1997.

resignation. Contemporaneously, there was a statement by the minister of state services at the time, the Rt Hon Jenny Shipley, linking the issues of chief executive accountability to remuneration levels for chief executives. The implication was that a tightening of accountability might be linked to an increase in remuneration.

The foundations of the standards report are that the centre of public sector management has shifted from the SSC to the chief executives, who have become 'the pivot in the New Zealand public service', and the report clarifies and makes explicit principles codified in other documents.¹⁴⁶ The standards letter developed in this report attends to intangible aspects of the chief executive's performance expectations including "service to the minister, representing the department, leadership, professional ethics, statutory independence, the collective interest and collegiality". The report also addresses personal responsibility and accountability, noting recent public attention to this. It sets out to make explicit the SSC's expectations in this regard and how it will balance "the public demand that in cases of serious departmental failure, there will be clear accountability, and the need for dignity and natural justice in matters relating to individuals".

It is worth noting the main points in the standards report that touch on the issues in this book:

- emphasising free and frank advice;
- ensuring a productive, professional and effective relationship with the minister;
- providing early warning of potentially controversial matters;
- striking a balance between fostering innovation and minimising risk;
- being politically neutral, including a prohibition on initiating contact with MPs or political parties;
- demonstrating leadership skills including enhancement of future departmental capacity;
- having high ethics and avoiding conflicts of interest or partiality in decisions;
- accountability to parliament for the department;

¹⁴⁶ State Services Commission, *Public Service: Principles, Conventions and Practice – Guidance Material*, Wellington, 1995; State Services Commission, *New Zealand Public Service Code of Conduct*, Wellington, 1995.

- acting independently under statutory authority does not mean acting alone; chief executives must relate departmental work to broader government objectives and work collegially; and
- developing senior management for succession.

Reflecting on the case studies above in the context of the standards letter, the difficulty over the appointment by Perry Cameron of Frank Sharp to the position of civil defence co-ordinator could be seen in light of the following quote from the report: “The duty to act independently on certain matters does not negate your responsibility to keep the minister informed on matters of importance”.

The parts of the standards report that codify expectations where there had been no previous attempts to do so are in the area of personal responsibility for performance failure. Where the SSC is satisfied there is just cause or excuse, it may remove a person from office, which requires an order in council, and, therefore, the cabinet’s agreement. The SSC would, in these circumstances, consider the materiality, the controllability and the manageability of the events of performance failure.

Provision is made, in the standards report, for failures where the chief executive is not personally culpable but is under public pressure to resign. In such circumstances, the chief executive may take the view that “the events that have taken place, and the public perception of them, will preclude or seriously impede the chief executive from continuing in office. The chief executive may consider that in those circumstances the appropriate decision is to resign on the basis that although there is no legal obligation to do so, that course will serve the greater public interest”. In these circumstances “the commissioner, ... who must act independently to ensure the political neutrality of the public service is not compromised ... must strive to provide the chief executive with the opportunity to reach a decision free from pressure”. When such a resignation is accepted, the state services commissioner may pay compensation for loss of office.

When a serious issue of performance arises, the state services commissioner may seek agreement from the chief executive to stand aside on the basis of a prima facie case. If the issue is such that removal from office is appropriate if the prima facie case is proven, then the state services commissioner can suspend the individual from office pending full consideration of the case.

Finally, the standards letter notes the obvious in stating that “nothing in this statement is intended to alter the legal rights and duties of the commissioner or a chief executive”. This is significant in that all these

provisions are subject to the normal requirements of state sector and general employment law. Chief executives are employed under formal contracts of employment and could challenge any adverse action against them through the courts.

The 'standards report' was a step forward in the clarification of the responsibilities of chief executives. It successfully brought together well-established principles and practices in a crisp statement of the SSC's expectations of chief executives. It is, as it claims to be, a 'summary reference point'. The process by which it was developed has led to acceptance of its contents by the chief executives. There is little in it that is unfamiliar to experienced executives, but it will be particularly useful to new recruits. It establishes the SSC's position in regard to the handling of serious performance problems more clearly.

It is clear that there are many circumstances where the accountability of a chief executive is sufficiently separate from that of the minister for the chief executive to resign but not the minister. If this seems obvious today, it only shows how much things have changed.

The codifying of the possibility that a resignation, once offered, may not be accepted is helpful and will be a satisfactory response in some marginal performance cases. This parallels the same possibility for ministers. This situation did occur in fact when the minister of finance, the Hon Roger Douglas, offered his resignation over an accidental distribution of some copies of the budget. The prime minister turned down the resignation.

The expectation that a chief executive might choose to resign in circumstances where the SSC is not pressing for that but the chief executive feels that the wider interest of the public would be served by doing so, is satisfactory as far as it goes. In ambiguous cases it is realistic to leave it to the chief executive to decide on the best course of action. The standards report does not mention, however, the likely possibility that the SSC might actually think the person should go even though there are no contractual grounds for severance. The standards letter paints the SSC in the role of protecting the individual employee from public pressure on the grounds of resisting political influences. This is essential for ensuring the chief executive is not used as a scapegoat for problems that have other causes. As a practical matter, however, the SSC's wider concerns for the standing of the public service would have it, on occasion, in the position of saying in effect 'we cannot make you leave under your contract but we think you should. Can we negotiate a pay-out?'

A matter that should carry weight for a chief executive in considering whether to resign, or for the SSC considering a termination, is whether the performance problem is undermining the department's capacity to carry out its functions, or the minister's capacity to carry out their functions. This could include impediments due to serious damage to the reputation and credibility of the department. The statement cited earlier in this chapter by the chief executive of Mercury Energy is clear about this. Clauses in most senior employment contracts, both public and private, are explicit about termination for adversely affecting the reputation of the organisation.

The standards report is not explicit about how serious it is to mislead parliament, although its definition of accountability implies this is serious misconduct. This question arose in respect of information given by the Serious Fraud Office in connection with the 1997 'winebox inquiry' into the work of the Inland Revenue Department and the Serious Fraud Office in investigating certain tax avoidance schemes. The point was not tested, at least in public, as the director retired of ill health following evidence before the inquiry that indicated that parliament had been misled about how much work had been done by the office in investigating the schemes before judgement was passed on them.

Within the performance agreement of a chief executive, there is an issue of priorities that should be factored into judgements of performance. Chief executives should be held liable for the job they are actually employed to do in a particular department facing particular challenges at a particular point in time, and not in terms of some generic statement of their responsibilities. While there are some general requirements for diligence and propriety, the state services commissioner should tell chief executives what the key performance criteria are when they are appointed and from time to time after that. It is counter-productive to require a chief executive to focus on some major goals and then be too demanding in relation to performance on other dimensions. The SSC has previously expressed a view that a chief executive's personal performance is separate from that of the department. This thought is not present in the standards report, and nor should it be. The public and the government are interested in the performance of a chief executive in terms of the services that the agency delivers and the condition of the agency, but not in terms of some abstract notion of good management separate from the performance of the agency.

The inclusion in the standards report of criteria of controllability and manageability in assessing performance failures is well-founded. There is a necessary distinction between that which chief executives may be personally

required to manage and that which comes more broadly within the range of things for which they are responsible by virtue of being the chief executive of the department. In the latter case, chief executives will be responsible for identifying what has happened, reporting accordingly, and taking any necessary action to put things right. As far as their own liability is concerned, it should be judged by the adequacy of their managerial performance and the management systems and internal environment they have created. Chief executives, like ministers, can be responsible but not necessarily to blame for failures in problematic departmental performance.

The distinction between the managerial competence of a chief executive in an ongoing sense and serious 'one-off' events should be kept in perspective. The latter should be treated with the seriousness they deserve but it is the possibility of endemic under-performance that is likely, in practice, to be a more significant long-term risk to the effectiveness of government management.

The references in the standards report to chief executives having an explicit and broadly defined 'duty of care' are well made. A chief executive would not be able to avoid the consequences of this duty simply by establishing that a particular obligation was not explicitly spelt out in their performance agreement. There is substance to the expression 'it happened on my watch' – a phrase actually used by John Fernyhough, the chairman of the Electricity Corporation of New Zealand (ECNZ), after the 1992 power crisis. This doctrine ensures that a chief executive is always alert to the total performance of the organisation.

However, the notion that resignation should be based on a concept of vicarious accountability for things one could not be expected to have prevented is potentially dangerous to the performance of the public sector. It should be carefully defined and the code implemented in a way that limits it to extraordinary circumstances. The specific details surrounding a performance failure are important. The standards report foreshadows this. A sound judgement about culpability should take account of the nature of the particular failure, the resources available to the chief executive and the extent to which possible risks may have been anticipated. The judgement should also take into account the priorities that the chief executive was directed to address and the general context in which they were operating.

Where the minister and the SSC have decided not to take action and treat a matter as a performance issue themselves, it is then up to the individual chief executive to decide whether to stay or to leave their position as discussed above.

The references to 'free and frank' advice in the standards report are important as they affirm a central obligation on chief executives regardless of the preferences of their ministers. For example, if a minister tells a chief executive not to provide policy advice, as happens sometimes, this instruction does not remove the obligation from the chief executive to tender such advice. Such examples also highlight the need for chief executives to be able to seek the advice, support and assistance of the state services commissioner to resolve such fundamental difficulties with ministers. The erosion of the 'free and frank' doctrine that happens periodically must be resisted.

CONCLUDING COMMENT

The concepts of chief executive/ministerial accountability are basic to the whole philosophy of public management. They balance the deep delegation of management authority. In year by year operations these concepts take the form of explicit commitments to deliver on clearly stated performance objectives that are decided in a process of negotiation and agreement between chief executives or boards and ministers, supported by their advisers. For the most part, routine assessments of performance within the bounds of conventional acceptability are made, satisfactory executives are offered new contracts, unrealistic performance goals are modified, parliamentary committees pose hard questions and so on.

When things get off track or there are major performance failures, the management system shifts gear and other processes take over. These hard cases are, however, the furnace in which clearer principles must be forged. The principles and practices of accountability that then emerge at these hard edges should feed back into the routine management system and should have powerful effects on incentives and behaviour. It is fundamentally important that these hard performance cases proceed in accordance with sound principles and that overt precedents are built up over time. The public may at times still want to see someone 'swinging from the gibbet' as a former state services commissioner colourfully put it. The public also wants high-performing, ethical, well-managed government departments that it is not going to get unless the management system sets fair and reasonable conditions of reward and sanction for performance for the top managers. The public will be disadvantaged in the longer term if actions taken at these times, or uncertainty about accepted principles, are allowed to distort the total structure of relationships at the core of the management system. This will occur if crude accountability results in chief executives feeling that they

are working in an atmosphere of uncertainty or arbitrariness, which would exacerbate the existing difficulties in recruitment and retention of senior staff. Chief executives might also become reluctant to delegate to line managers.

The guardian of the principles governing the relationships between politicians and public servants is the SSC, which must be backed by the prime minister because breaches of standards are as likely to be incurred by ministers as by chief executives. A core role of the SSC must be to perform this role with clarity, openness, fairness and despatch. Whatever response to public demands is made, the driving objective is to improve the reputation of the public service. Any change must be designed to enhance the effectiveness of the totality of the relationship between minister and chief executive and not distort it by a narrow focus on single elements.

The provision for dealing with fundamental breakdowns in relationships between ministers and chief executives on a no-fault basis is a mature and fair response to the realities of government, so long as it is rarely used.

The employment protections arising from employment law are greater than was envisaged in 1988. The employment law gives chief executives the option to resist the state services commissioner by legal means if they are called to account. The SSC and ministers appear to have been reluctant to go to court over contractual disputes. However, if they have confidence in their own decisions, they should be willing to have them tested in court.

Whatever is decided, significant change in the employment conditions of current chief executives should be addressed as a contract revision with the potential to adjust other terms and conditions. Senior public servants are, with only rare exceptions, hard-working talented people motivated by the public interest. The undertaking to them at the time the State Sector Act was enacted in 1988 was clear. Continued employment depended on continued good performance within a five-year time frame. In exchange, salaries were to be broadly benchmarked against private sector equivalents. The accountability side of this has not turned out quite as planned and neither has the remuneration. It is time to revisit the original deal.

While there have been some apparent weaknesses in accountability for poor performance and failure, a comprehensive view must recognise that government departments are subject to a wide range of other safeguards and accountability mechanisms. These range from the activities of parliamentary select committees and the requirements of statutes such as the Public Finance Act 1989 and the Fiscal Responsibility Act 1994, to the operation of the New Zealand Bill of Rights Act 1990. Also there is the Official Information Act 1982 and the constantly evolving administrative law, which is a powerful

tool for reviewing administrative action. There are the activities of influential 'watchdogs' such as the ombudsmen and the privacy commissioner, and less formal sanctions, such as the constant scrutiny of the news media, which are, however, generally poorly informed of the significance of the issues being discussed in this chapter.

The personal liability of chief executives of government departments is not as clear as it should be. The Public Service Code of Conduct provides sound general principles for the proper conduct of chief executives. Together with the SSC standards report, and the accumulating lessons from case studies, the practical details of the accountabilities of chief executives for performance problems will emerge more clearly over time. The standards report, which is a step forward in the clarification of the expectations of chief executives, establishes better the expectations of chief executives when things go wrong and provides for consideration of the degree of control of the situation that the chief executive had in the circumstances.

There is a real risk that chief executives could be made a scapegoat in particular cases where the actual situation is complex. Concern about the possibility of this may tend to discourage chief executives from seeking or accepting appointment and it may also influence the way they behave if they were to take an appointment. This issue should be of concern for two reasons. Anything that discourages potential chief executives from seeking appointment would limit the pool of people available to take on these key roles and would increase the cost to the government of making such appointments. On the other hand, the new management system relies on chief executives being willing and able to apply innovative approaches to the achievement of departmental goals. The creation of a strongly risk-averse culture among chief executives would be counter-productive. The accountability principles for chief executives should be clearer than they have been and they should combine with other elements of the management system to ensure that the total public management philosophy does not revert to rule-bound defensiveness.

Accountability doctrines and practices are, however, only one facet of the relationship between politicians and public servants. Whatever is done to review and tighten these practices and doctrines must make the totality of the relationship more productive in terms of more effective governance and service delivery. It must not advance one objective at the expense of the whole.

SETTING AND MONITORING PERFORMANCE SPECIFICATIONS: OUTPUTS AND OUTCOMES

INTRODUCTION

The New Zealand public sector reforms are notable for their emphasis on the specification of performance, which is fundamental to the whole concept of accountability.

The State Sector Act 1988 made chief executives accountable for the performance of their departments, but it did not develop the concept of performance beyond the conventional reference to economy, efficiency and effectiveness. In the policy development leading to the Public Finance Act 1989, the concept of performance was elaborated. Two key distinctions were made, which largely determined the nature of the formal performance management system.

The first distinction was between the purchase and ownership dimensions of performance. This recognised that the way an 'owner' defines performance is in terms of capital maintenance, profit, return on assets, investment in future capacity, the quality of management and other related matters. In contrast the purchaser of an organisation's services is interested in whether the services delivered are as agreed, with performance referring to issues of service quantity, quality, timeliness and cost, amongst other possible dimensions. In a public sector setting, the minister is, in relation to a department, normally both owner and purchaser, and is therefore interested in performance on both these dimensions. Chapter eight considers ownership performance. This chapter elaborates on the purchase performance.

The second distinction in performance, made in the early policy work, was the distinction between outputs and outcomes. Outputs are the goods and services produced by an organisation for an external party, such as ministers or consumers. They are under the control of an organisation. Outcomes are either the impacts of those goods and services on the community or other interventions such as regulation. Governments often deal in high-level outcomes such as reducing the road toll, because the people whose votes they seek want better outcomes and are persuaded – sometimes erroneously – that politicians can do something to improve them.

The public sector reform focus over the past decade has been on using outputs for accountability. The original intention behind the design of the accountability framework was to build on the framework to incentivise managers to be concerned about outcomes. This has been a neglected area.

This chapter sketches the concepts of performance in the management system and the reasons for it in the minds of the designers. It examines the reasons for adopting the output concept in contrast to other possibilities and describes the formalities through which the output concept is made operational. A critical stocktake of the current practices surrounding the output concept in action is provided. The roles of outcomes, policy analysis and evaluation within the management system are described and developed. The subject matter largely concerns departments but also applies to Crown entities, with a few modifications, as described in chapter ten.

ABOUT OUTPUTS

What are outputs?

Outputs from government agencies are the goods or services provided externally. Examples are policy advice for ministers, health services for the public and the payment of social welfare benefits to beneficiaries on behalf of the government. A template for describing an output and an example of an output appear in the appendix to this chapter.

The role of ministers in respect of outputs

As a purchaser, the minister acts as a member of the cabinet who is planning and negotiating the services required from the department, in order for the government to meet its policy objectives. This view of the role of a minister emphasises the importance of policy analysis and advice, which addresses the relationship between a certain set of outputs, or other interventions such as regulation, and the minister's policy goals, being the outcomes. Ministers might expect to get advice on this relationship from the department providing the service, but might also expect advice from independent sources. This desire for independent policy advice was a reason for the government's establishment of independent policy agencies, which occurred over the same time period as the state sector reforms. These matters were discussed in chapter five.

Properly implemented, the output concept promotes a degree of detachment from the legacy of what has been done in the past. It creates incentives for departments to produce services arising from an analysis of

present and future policy requirements, rather than assuming that the past services will still be required. It promotes questioning about what is being produced and what it costs. Rather than ministers or central agencies having to argue that a service does not add value, from a position of less information than the department has, the burden of proof shifts towards the department. This means the department has to demonstrate the value added by its existing or proposed services.

Outputs provide ministers with information about what they are getting for the money provided. In this sense departments become more customer focused. It is easier for the ministers and the top managers in the department to identify, assess and prioritise services. These are the characteristics captured in the term 'purchaser'.

An active and discriminating minister creates strong incentives on a department to produce clear specifications and to be innovative and forward looking in the mix of outputs proposed. To assist ministers to apply this pressure on departments, funds have been made available to ministers to retain the services of 'purchase advisers', as discussed in chapter five. Where ministers have utilised purchase advisers, and where they have operated as active and discriminating purchasers, the quality of output specification has tended to be higher than that from ministers without purchase advisers. Where contestability of supply existed, ministers could choose alternative sources through contracting-out or other approaches, although few ministers have ever done so.

The formal place of outputs in the management system

Outputs are a key element in the formal mechanisms of accountability. Departmental appropriations, which departments receive via their minister, are designated for a specified set of 'output classes'. These output classes are groups of homogeneous outputs. The appropriation is for a level of expense that may be incurred by a department in producing that set of outputs. While the appropriations documents contain some detail of the specific outputs or services to be delivered, greater detail is captured in the departmental purchase agreement. This agreement is between a minister or ministers, where a department has more than one, and the departmental chief executive. While the appropriation documents are intended primarily for parliament, the purchase agreement specifies in more detail the minister's expectations of the department and is a management document within the government. The purchase agreement was designed to be an essential element of a chief executive's performance requirements.

Each quarter, departmental chief executives prepare performance reports to their ministers. These reports focus primarily on the delivery of services relative to the purchase agreements. This reporting process is also an opportunity to reconfigure the set of outputs, if changed circumstances suggest that this is necessary. Obviously, such changes to outputs will occur only with the agreement of the minister.

Outputs are also the focus of the 'statement of service performance', published as part of the departmental annual report to parliament. This statement provides external accountability for services delivered, and is subject to audit.

The various mechanisms for scrutiny and accountability are designed to operate as a coherent system and to reinforce one another. The output focus throughout the formal management system is intended to make this possible. Outputs are a critical feature of departmental chief executive performance agreements, departmental annual reports, the budget process within the executive, the parliamentary estimates and the annual appropriation acts.

The reasoning behind the use of outputs in New Zealand

There were a number of practical and conceptual reasons for the adoption of the output concept in New Zealand. Prior to the public sector reform, performance expectations were largely implicit or they related to the departments' compliance with controls, which were expressed primarily in terms of the inputs consumed. Corporate plans expressed departmental purposes in very general terms that were not linked to the use of resources or to outcomes. Outputs were only present in fully commercial activities and, even then, relatively little attention was paid to the provision of clear specification of these outputs.

The concept of services that are delivered by public agencies as outputs can have powerful effects on incentives, information and management systems. Outputs clarify the production functions for public services and facilitate arrangements for internal markets, contracting-out and benchmarking. Where arrangements for real or notional contestability are impractical, or are excluded for policy or ideological reasons, the output concept still has the advantage of promoting transparency in management information, in the allocation of resources and in budgeting. There may be other ways to achieve these benefits but a system using outputs clarifies what is being produced, and what it costs, which is an important contribution to better public management.

Issues for ministers at the time

The starting points in the rationale for outputs were the problems that ministers sought to address through the state sector reforms over a decade ago. There are three problems that bear directly on the selection of outputs as the focus of the management system. First, ministers had poor information about the specific activities being carried out by departments. While ministers would be conscious of specific services that attracted their attention, they were frequently poorly informed across the whole range of departmental services; indeed many staff in the departments were also unaware of the range of services that their department offered. Associated with this was the perception on the part of some ministers that many of the services being produced by departments were not highly valued, either by themselves or by the recipients of the services.

Allied to the lack of ministerial knowledge was the perception on the part of ministers that the system as a whole was unresponsive to their policy preferences. Ministers, in seeking to implement a policy, might find that their intentions were not being given effect to, or not being implemented as quickly as they wished. At the same time, ministers and central agencies had a very detailed set of controls over the inputs that departments used in the production of services. Examples were the detailed controls over personnel, purchasing, accommodation and travel. This left ministers in a position where they felt unable to achieve the degree of control they wished over the services delivered, even though they had a range of detailed administrative control mechanisms at their disposal.

Ministers felt that the mechanisms by which they held departmental heads accountable for the management of their departments were extremely weak. They perceived at least two dimensions to this weakness. The first was the lack of appropriate performance incentives, which were, in part, explained by the permanent tenure held by departmental heads, and the second was the lack of prior specification of services to be delivered during a given period. In the absence of such prior specification, it was difficult to extract subsequent effective accountability. Those ministers generally became frustrated with unresponsive and territorial behaviour by many senior public servants, especially in the commercial activities of government. This is one reason why the New Zealand public sector reforms placed so much emphasis on getting clear expectations of chief executives' performance stated at the beginning of a period.

There was also a serious fiscal problem sitting behind the management reforms that was creating political stress for the government, whereas the public service gave the impression that it was business as usual. Ministers

were very annoyed with the way in which information was presented to them by departments. They were accumulating anecdotes about how resources were not focused on the urgent priorities of the day.¹⁴⁷ Ministers were confident in their ability to set priorities, if only they could get high-quality information about what they were funding already, in a way that reflected the services being provided. Information about the costs of amorphous 'programmes' was of little use. These concerns of ministers led to the government's decision to use outputs in the formal management system.

Weaknesses with programme budgeting

Prior to the adoption of an output focus, New Zealand, in common with many other countries, had adopted a programme budgeting system. Most countries still use it. In concept, a 'programme' can probably be best described as a set of services or outputs intended to achieve some particular policy outcomes of government. Programme budgeting had been introduced in New Zealand shortly after its initial development in the United States. An American expert, Ed Winchester, was engaged by the New Zealand Treasury to advise on the implementation of the system. By the time of the state sector reforms, the programme had been in operation within the New Zealand government for almost 20 years. It had, however, resulted in relatively little improvement in decision making, although accounting information was to some degree enhanced as a result of the introduction of this system. Other countries, most notably Australia and Canada, pushed programme budgeting further than New Zealand, with more apparent success.

Programme budgeting did not work in New Zealand as intended for a number of reasons. There was one reason of principle and one of practice for this failure that influenced the decision to adopt outputs.

In principle, a programme was the set of services designed to achieve a specific outcome or policy objective. This meant also, in principle, that outputs or services needed to be unambiguously assigned to specific outcomes, that is if there was to be any prospect of attributing costs to those outcomes. However, many services contribute to more than one government policy outcome. Education services, for example, contribute to a range of different outcomes including economic development and health. This meant

¹⁴⁷ Richard Prebble, *I've Been Thinking*, Sentra Printing, Auckland, 1996. (A popular book on the subject by a senior minister in the cabinet at that time.)

that an unambiguous assignment of outputs to outcomes involved a significant departure from reality. Either that or it meant that 'programmes' were defined in a way that did not reflect the underlying concept.

In practice there was also the problem that services were not clearly specified, neither were their costs estimated accurately. Budgeting was based on organisational units. For example, most departments had a programme labelled 'administration'. This was contrary to the rationale for programme budgeting, yet was an easy solution in administrative terms. In practice, programmes were often poorly defined or were identical to organisational structures. They did not support dispassionate allocation and reallocation of resources, and tended to support, instead, the status quo.

The drive for greater accountability for performance

Ministers were concerned to establish greater specificity in the accountability for performance in government organisations as were officials in the central agencies. The Treasury post-election briefings in 1984 and 1987 argued for clarity in performance expectations of chief executives in the advice on how to improve the management of the public sector. The SSC was also arguing along these lines from around 1985. Unless chief executives are clear about their performance requirements they are very unlikely to be able to motivate their departments to meet government goals.

The output focus provided the key to clearer and stronger accountability relationships between ministers and chief executives. It was not intended to reduce the attention to outcomes, which were in fact also given a significant place in the system design. However, the ultimate importance of outcomes does not mean that formal accountability should be only on outcomes, if such accountability cannot effectively be implemented.

Accountability for high level outcomes is difficult to enforce, because outcomes are typically the result of a wide range of factors that are only partially within the control of an individual chief executive. Also, the causal relationships between outputs and outcomes are frequently not well understood. Further, there are problems in holding managers accountable when the timeframe is such that the outcome may not be visible for many years, as, for example, with education. In addition, many outcomes are difficult to measure. Thus, holding chief executives accountable in concrete terms only for high level outcomes is unlikely to be successful.

Attempting to do so has great potential to descend into a debate about evidence, causality and degree of control. Used as the central accountability

concept, the outcome focus creates a rich opportunity for plausible excuses. As Wilson¹⁴⁸ notes in a police management context, police chiefs in the United States are never fired because the crime rate goes up. Implicitly, this points to the difficulty of holding a chief executive accountable in outcome terms.

The challenge is how to motivate government organisations to identify and pursue better outcomes while extracting the value of the concept of controllable outputs for tightening management processes. This challenge, together with the question as to whether the key role for outputs has introduced a distortion away from concerns for outcomes and government-wide interests, is discussed below.

The output concept also supports managerial accountability by facilitating the link between chief executive and departmental performance requirements and budgets. It promoted more rational dialogue around how much could be achieved for a specified budget. Input costs can be attributed to outputs. While this technology is sometimes arbitrary and frequently criticised, it is hugely more reliable than would be any attempt to attribute input or output costs to outcomes. This attribution would be possible only by making gross and highly arbitrary assumptions about output–outcome relationships.

Finally, the designers hoped that greater clarity in respect of outputs would encourage departments and ministers to consider more carefully the issues of service design and output mix. Ministers would play a key role in making this part of the system work.

Assessing the output concept in action

The effectiveness of the output concept in action can be evaluated in a number of ways.

Reactions of politicians

The reactions of ministers at the time outputs were introduced was favourable, especially those who were involved in the budget. I remember the delighted reaction of the minister of finance, Rt Hon David Caygill, and the associate minister of finance, Hon Stan Rodger, at the time they received the first spreadsheet of budget data on an output basis in 1990. For the first time it was possible for finance ministers to see what they were paying for what they were getting, even though the initial classifications were crude in

¹⁴⁸ Wilson, *op cit*, p 132.

some respects. Some ministers in that government were not very diligent in setting up output-based performance agreements with their chief executives although their budgets were still processed on an output basis.

After the National party won the 1990 election the cabinet insisted that output-based performance agreements be developed for all departments. The Hon Doug Kidd, who was the minister in charge of imposing cuts and constraints on public spending for the 1991 budget, became enthusiastic about the benefits of output-based budget information after he experienced some difficulties with addressing line items and inputs.

Ministers since that time have only known output-based financial and performance information and have generally used it as it was intended to be used.

The reactions of parliamentarians to the idea of output-based performance agreements for all departments are probably best gauged by the select committees that were involved in the passage of the Public Finance Act in 1989 and in subsequent revisions of this act. At each stage the committees were not only supportive of the scheme but also made a number of practical and conceptual contributions to the approach.

The 1999 Labour/Alliance government has made criticisms of the 'contractualist output model'. The criticisms focus on the costs of detailed contracting in some instances, and on a perception that trust and co-operation between ministers and chief executives have been lacking. These criticisms have been discussed in chapter three. The minister of state services has, however, indicated an intention to have output agreements and has stated that the underlying statutory arrangements, including the Public Finance Act 1989, are satisfactory.¹⁴⁹

Coverage

All government departments were using outputs in their processes of budgeting and accountability by 1990. An expanding range of enterprises have also adopted outputs in their management systems. Crown entities were not initially included in the output system because the government decided to deal first with government departments. The political and administrative risks of changing the managerial regime for departments and many hundreds of Crown entities at the same time would have been too

¹⁴⁹ Hon Trevor Mallard, "Complying with the new government's priorities and plans for improving public sector performance and accountability", speech to Chen and Palmer seminar, 4 July, 2000.

great. Later, after departments became comfortable with the output focus, they became concerned that the Crown entities, which in many cases they monitor on behalf of their minister, were not subject to the same output specification requirements, and therefore the same level of accountability.

In 1997 in response to pressure from departments and the Office of the Auditor-General, cabinet took a decision to require purchase agreements from all Crown entities. Some Crown entities have made progress in developing a sensible basis for purchase agreements but there is much work to be done for many of these organisations.

Quality of output specification

Poor output specification engenders poor performance. Departments put considerable effort into the initial specification at the level of output classes. This was one of the conditions that had to be met before a department would be permitted to move on to the new management system. The reason for devoting this level of attention to outputs was a lesson from the programme budgeting experience. There, it appeared that where programmes were poorly specified initially, it subsequently became extremely difficult to get better specification. If anything, there was a tendency for the quality of specification to degrade over time.

Given that each output class is a separate, legally enforceable appropriation, there is an incentive on chief executives and ministers to have fewer rather than more output classes. Within an output class, departments have flexibility over the outputs they produce. However, they have very little flexibility over switches between output classes. This has been a factor in the efforts of some departments to consolidate output classes. It was considered appropriate, for both parliamentary purposes and the ministerial role, that departments should not have the capacity to determine the mix of outputs, as well as the mix of inputs, used to produce these outputs. Fortunately, there have been relatively few examples where departments have been able to persuade the Treasury and ministers to allow them to do this, in effect, by aggregating output classes too highly.

In the expectation that outputs could become rigid or degrade over time, the effort put into getting high-quality specifications at the outset was reinforced by the later introduction of more detailed specifications of outputs within the departmental purchase agreements. An interdepartmental review group and the Treasury guidelines supported these. These developments have assisted in the protection of the initial quality of output specification, and have facilitated the further level of detail required in the purchase

agreements. The development of purchase agreements themselves implies an improvement in the quality of specification over the initial specifications, which were at the output class level.

There are a number of mechanisms designed to assist departments in achieving high-quality output specification. The effect that ministers have on the quality of output specification is discussed above. Reformers envisaged that departments would have strong interests in the nature and quality of their products and services, but also the incentive to ensure that their products met the outcome objectives of ministers. It cannot be realistically assumed that all ministers have all of the personal skills to be effective purchasers, but they must retain responsibility for this. The process leading up to ministerial sign-off must be well-informed and thorough.

A further mechanism to ensure adequate output specification has been the interdepartmental review group that reviews annually the purchase agreements of departments. This group was serviced by the Treasury, and included representatives of a number of departments. Part of the intent of this review process was to create some peer group pressure for high-quality output specification. When the system was first established, departments were encouraged by central agencies to imagine that their department did not exist, and they were assigned a budget to acquire the same services through contracts. Putting themselves in the role of a purchaser standing back from the production process helped departments achieve clearer specifications of their own outputs and the performance expected of them.

One particular type of output, that of policy advice, has received much attention over the years. The importance of high-quality advice has been reflected in greater attention being paid to what constitutes good policy advice within departments. The Treasury has put considerable effort into this. The SSC has also contributed through its publication on policy advice.¹⁵⁰ These efforts have been directed primarily at seeking to improve the quality of advice received by ministers, thereby assisting them to make effective decisions about output specifications. There is still good reason, however, to be concerned that policy skills in many agencies are not up to the demands of the sectors in which they operate.

Parliamentary committees and the auditor-general have roles in creating pressure for high-quality and clear output specifications. Select committees should be critical of output specifications, whether in budgetary documents

¹⁵⁰ State Services Commission, *Policy Advice Initiative: Opportunities for Management*, Wellington, 1992.

or *ex post* reporting, which do not enable the reader to get a clear view of the service being provided.

The effectiveness of select committees in reviewing departmental performance against specifications has been disappointing, with some exceptions. Most notably two former finance ministers on the finance and expenditure committee (the Rt Hon David Caygill and later the Hon Ruth Richardson), were skilled and vigorous in exploring the implications of performance information for government policy and administration and in exposing performance weaknesses. Typically, however, select committees do not attempt to examine performance systematically, but rather pursue particular issues of interest to individual members, sometimes including matters beyond the formal terms of reference of the hearings. As Rt Hon Simon Upton has stated:

I have often been embarrassed by the way in which MPs treat public servants. The recruitment of external boards to Crown entities and SOEs has led to some improvement but only some. There are courtesies and basic businesslike practical practices that are routinely ignored by politicians who look and act in a very amateurish way. It is no different in select committees. All manner of exciting inquiries are being pursued while MPs haven't the time or inclination in many cases to really get inside the accountability documents that give committees unparalleled insights into the quality of both ministerial and corporate governance. Holding ministers to account for their stewardship of public money is often secondary to the pursuit of current political headlines.¹⁵¹

The questionnaires that request performance information from departments are adequate and the terms of reference for committees' review work are sensible. The reasons for the indifferent quality of examination of performance appear to be the incentives, capacities and interests of committee members. Few have had any experience in the management of large organisations. The hearing provides a scarce opportunity to extract information on particular issues and to make political points about a department and its minister. The public they represent are more interested in particular issues than wider and more subtle questions about the general level of a department's performance. A much greater effort is needed by Parliamentary Services and by the political parties to train MPs to exercise their constitutional responsibilities to investigate the performance of the

¹⁵¹ Rt Hon Simon Upton, speech to the New Zealand Legal Research Foundation, 21 September, 2000.

executive by reviewing its success or otherwise in meeting coherent performance expectations.

The auditor-general is parliament's agent in respect of this responsibility and must provide opinions about departmental performance. These have an important influence irrespective of the level of the interest that select committees have. The Office of the Auditor-General has published a standard on the audit of statements of service performance. The standard requires audit service providers to consider the appropriateness of the measures reported in the statement of service performance. This should also act as an incentive to have clear output specifications because inadequate specifications could lead to qualifications in an audit certificate.

Portfolio reviews

Having the prime minister review the purchase decisions of ministers would provide added incentive for ministers and chief executives alike to ensure high-quality output specifications and performance agreements, backed by sound policy analysis. A model is provided by the system of portfolio reviews used in the Victorian government under the Kennett administration, where the premier reviewed the performance of individual ministers and their departments. In 2000, the minister of state services said in a speech¹⁵² that there may be a change in procedure so that the minister and the chief executive will jointly submit an annual report to parliament. This could lead to an improvement in accountability for results and possibly less duck-shoving by ministers. However, whether it brings an improvement in performance, service, integration and accountability depends on the details. It will not bring about improvement if it confuses the respective roles and responsibilities of officials and ministers. It will help particularly if it promotes better information and evaluation of a whole ministerial portfolio as discussed elsewhere in this book.

Output pricing

A recent area for policy development has been output pricing. Output pricing seeks to move the contracting between minister and department from a basis of costing the production to determining prices independently. One of the notable features of the attempts to determine an appropriate price

¹⁵² Hon Trevor Mallard, *Complying with the new government's priorities and plans for improving public sector performance and accountability*, speech to the Public Sector Performance 2000 conference, 3 May, 2000.

for services is that it has led to more powerful incentives for clarity in output specification. The most significant feature of this change has been the recognition that increased detail is necessary in order for the output contract or agreement to be meaningful. Currently, although some people express concern that the amount of detail in purchase agreements is too great, the level of specificity in agreements is still dramatically less than one would normally find in a commercial contract. This information should be the starting point for internal management purposes in a well-run department.

Output pricing, in the absence of contestability of supply, is inevitably an argumentative process about cost data and their interpretation, hypothetical alternative technologies and management systems. For example, departments will argue that their products are not comparable with benchmarks proposed by the Treasury. However, there are grounds for believing significant progress can be made.

The use of the generally accepted accounting principles, the liability for goods and services tax and the imposition of a capital charge on departments ensures that the costs of outputs can be measured in a manner directly comparable amongst public agencies and between public and private sectors. The benchmarking methodologies and databases developed in the private sector, and increasingly in some public sector activities in the United States and elsewhere, offer examples.

The health sector has the most developed methodology for benchmarking prices where tendering and contestability is muted by policy or market structures. The HFA spent around half its \$7 billion budget on services from the public hospital companies or Crown Health Enterprises (CHEs).¹⁵³ Several years of effort in statistical analysis and modelling have gone into developing standard product and service definitions with associated benchmarked prices, which were used in the annual contracts between the HFA and CHEs. Nationally consistent prices have been estimated using 'data envelope analysis', which calculates an efficiency frontier that permits negotiation about efficiency gains over time. This pricing framework is augmented with further work using bottom-up costing methodologies.

The value of benchmarked pricing data lies in how it is used in the management of an organisation and the performance incentives it creates. Experience in the health sector shows that the studies must be embedded in a contracting framework and a wider relationship agreement that establishes

¹⁵³ Subsequently renamed Health and Hospital Services (HHS) in 1998, but the acronym CHE is mostly used throughout this discussion for simplicity.

prior agreement about what method will be used to collect data and what the emerging data will be used for. Otherwise, the arguments can be endless about when a particular figure for a price is sufficiently robust to be entered into a contract. Similar considerations will apply if the use of benchmarked prices becomes common for departmental appropriations. Agreements between the Treasury and the departments about methods and the use of the data will be needed.

Output pricing methodologies have been slower to be developed and implemented than I would have expected. Over time all outputs should be properly priced through the use of accepted methodologies. This should be done routinely by the government agencies themselves.

Internal use of output information

Many departments have adopted an output focus within their internal departmental budget systems, in order that these support the monitoring of appropriations and external accountability. It appears that departments may, on occasions, comply with their appropriations only through the use of practices that are quite crude in the way they allocate overheads to the direct costs of outputs. This area has been the subject of an Audit Office inquiry. Unquestionably, the better performing departments do actively manage the production of their outputs, and budget and monitor in those terms. However, this does not apply uniformly across the whole public service. The central agencies should continue to pressure, facilitate and resource the development of cost accounting practices that reasonably approximate the underlying economic costs of output production.

There have been a variety of responses to the incorporation of an output focus in departmental planning processes. The best run departments carry out their planning processes in exactly the manner envisaged. That is, they scan the environment for indications that the existing mix of services may need to be changed, they look to new and innovative services and production methods and they plan the development of new services over a number of years. In these cases, departments are explicitly considering their range of services and their client needs. At the other extreme, there have been departments that have continued producing the same set of services using essentially the same production methods since the reforms were implemented. The effect of this inertia has been reduced by the extent of restructuring within the public sector, which has tended to produce organisations with a clearer performance focus and a more clearly defined role. The new organisations, in general, are more focused on service delivery

and client needs. Endless restructuring in the hope of reinvigorating operations that go slack is costly and eventually counter-productive. The performance management system needs to be geared to promoting quality, efficiency and innovation in producing services.

Product innovation

There is always a risk in a government organisation that is not subject to competitive pressure to fall into established modes of service delivery. There needs to be an internal impulse, in an organisation such as this, to innovate and there needs to be encouragement in the surrounding incentives. Product innovation is a critical aspect of the use of the output concept in internal management. Innovation apparently varies across departments but there is no systematic evidence or established method for assessment. Effective processes of strategic management are good indicators of an organisation's commitment to product innovation. Commitment to a philosophy and to techniques of quality management and strong customer feedback are also indicators of an organisation's commitment to product innovation. The changed incentives associated with chief executive performance agreements were a contributing influence on innovation, as was the pressure for efficiency generated by budgets that have reduced in real terms over the period of the state sector reform. While there is less risk than under the previous system that traditional service configurations will be locked in, there may be a perception that innovation is not expected or appreciated, particularly where risks are involved. The budget process and the performance assessment process should be asking chief executives what they are doing to produce their services in better ways, to higher quality and for less cost than is being done at present.

It is encouraging that the Hon Trevor Mallard, as minister of state services, has stated that the government must be supported by an innovative public sector. Some of his predecessors also shared this view, but the reality is, that while there have been wonderful innovations in places, the pace of innovation in some areas of government could and should have been faster. Much has been learned about what promotes and what discourages innovation in public services. The announcements by the new government in 2000 about changes to public management have yet to catch up with these innovation issues.

Citizen feedback and monitoring

The state sector reforms were implemented from the centre of the government and were largely about ministers deciding what outputs would be produced and about assessing the quality of those outputs. Greater departmental effectiveness is achievable by the strengthening of the mechanisms for the recipients of services and non-government organisations to monitor the delivery and quality of services directly. This monitoring can be done more effectively if the government makes a clear statement about what it will provide to assist in the development of service standards.

There have been lessons learned from the experiences with the 'citizens' charter' arrangements in the United Kingdom and in other countries that use similar approaches. The early citizens' charters in the United Kingdom engendered some cynicism because they were promulgated by the providers, but there have been subsequent developments that improved the practices of monitoring the delivery and quality of services. An approach that develops service standards in consultation with service recipients is the most desirable and is increasingly a requirement of public law in New Zealand. Judicial review awaits the public organisation that makes a major decision that affects the public without due planning, process and consultation.

Experience in the health sector in New Zealand shows that service standards must be set in practical ways so that the public can readily understand them and can judge whether or not they have been met. Standards must be developed within the business planning processes of the delivery organisation, that is, if the service level being provided for is to fit within the budget and management capability. The accountability arrangements surrounding the HFA are based on these concepts. A document known as the 'statement of service coverage' was developed to provide a non-technical description of the services available. Previously, the government was inclined to express standards for health services and conditions of access in ways that were not readily assessable by the health service consumer.

A more powerful incentive exists where the citizen has the option of exit, that is, ceasing to use the service, with financial consequences similar to a customer going to another supplier. These options are only a practical possibility where the service is contestable. For many departmental services this is not the case, as they are not provided directly to the public. In the wider public sector there are many practicable options for giving citizens greater choice.

Monitoring and incentives

The philosophy of the public management system is to rely on the specific knowledge of managers who are motivated to achieve excellence within a framework of incentives devised by central agencies, involving transparent decision-making processes. Central agencies require managers to demonstrate that they have clearly established performance goals and have the systems in place to focus their efforts in achieving those goals and in monitoring and reporting progress in a transparent manner.

For managers, the output focus would produce additional benefits if output delivery was more transparent and could be more effectively monitored. In the past the monitoring of outputs was largely confined to departmental self-monitoring, augmented by the audit role. The emerging approaches to improved departmental performance management by central agencies should improve this.

Self-monitoring brings with it potential problems with incentives, in that departments will not always be motivated to identify and expose their own performance failures, although the best managed agencies do just that. The influence of transparency that a clearly expressed performance agreement provides is, however, considerable by itself, which is why routine monitoring should focus on transparency rather than second-guessing line agencies. Central agencies should not set themselves up as experts in the operational business of other agencies. This is especially so in the departments and Crown entities for which the performance goals are tightly linked to the internal management and external reporting systems. It is, therefore, highly productive for the central agencies to investigate and promote these linkages in their work on ownership issues, as discussed below.

The audit role is vulnerable to information problems. As with the cost allocation systems, there is still significant room within the management system for departments to 'fudge' their own reporting of service delivery. This applies both to internal reporting to the minister and to external reporting in the statement of service performance. The first version of the reformed management system put the onus squarely on the minister to monitor the output delivery of a department because that person carries the political accountability for performance. The later trend towards a more centralised management system implies that there should be a more prominent role for the central agencies in doing this monitoring.

In all this, the primary position of the minister must be kept in mind. The responsiveness of the management system will be lost if chief executives feel

that they are working for the central agencies and their minister is not interested in monitoring the performance agreement. If, in the minds of chief executives, the minister loses primacy in favour of the central agencies, some other informal monitoring system will rise up alongside the formal system and cause the latter to degrade.

It was envisaged by the reformers of the public management system that departments would have not only a strong interest in the nature and quality of their products, but also the incentive to ensure that their products met the outcome objectives of ministers. In response to the need to tighten strategic management across the whole of the government, high-level goals were developed in 1994. These goals became a key part of the performance assessment of chief executives. While this is a desirable development, it appears to have been accompanied by a lessening of emphasis on the delivery of outputs in the performance assessment of chief executives. This is a mistake and could, in time, cause the system to erode in terms of its accountability provisions. More work is needed to link the outputs to clear strategic goals. Focusing assessment on multi-year strategic goals will be far more effective if the linkages between these goals and the output-based business plans are clear. If they are not, there is a risk of performance assessment based on general strategic goals, undermining the delivery of outputs.

The monitoring and assessment of output production has been strong in so far as financial implications are concerned. The system for monitoring expenditure against budget works well. The auditor-general monitors for any breaches of departmental appropriations and invalid transfers between output classes. Breaches of appropriations have been rare and attract attention from select committees. The Treasury's role in the assessment process has been to provide comments about the quality of financial management in each department.

In other dimensions of performance monitoring and assessment, the system has not worked so well. The 'statement of service performance' produced by departments in their annual reports includes their non-financial achievements. These are not subjected to well-rounded assessments by the executive. In the past the Treasury's contribution to the assessment of performance by chief executives was restricted largely to the quality of financial management. The Treasury's wide knowledge of the performance of departments and Crown entities was not drawn on effectively. The central agencies were working in late 1999 to address the imbalance of performance assessment. They worked with chief executives to develop a simpler system

that integrates all aspects of performance in a unified process, centred on a single business plan. These issues are discussed further in chapter nine.

Contracting-out

The output concept clarifies the production functions for public services and facilitates arrangements for internal markets, contracting-out and what is known in the United Kingdom as 'market-testing'. The incentives on chief executives from their budgets and their performance feedback should be set up to ensure that opportunities to develop and assess alternatives are seriously entertained when available.

In some countries enforced contracting-out has produced dysfunctional results. A policy of compulsory contracting-out, as was implemented in the United Kingdom, could be distorting and could shift accountability for the results on to the agency imposing the policy. There have been examples in the United Kingdom where the set-up costs associated with putting a piece of work out to tender have been larger than the value of the contract in question. Pressure to look for alternatives should be created up to the point where it counterbalances the inherent bias in an organisation to keep work in-house.¹⁵⁴ Any centrally determined policy is likely to reduce the item-by-item consideration of whether a particular service could be delivered more effectively by a competitor service or in-house. Agencies should not generally contract out the activities at the core of why they exist in the first place, unless their existence is a question that should properly be asked. The better way to counteract the tendency for government organisations to produce in-house work that could be done more effectively on contract is to insist on the highest standards in the first place. Producers of low standard outputs should be questioned by ministers and central agencies as to why they do not go to new sources of supply.

Many ministers are relatively unconcerned with their purchase role and alternatives are not always readily available. Also, the process of merely looking for alternatives can damage the relational contract between a minister and a chief executive and can damage the department's capability if the search is done in a clumsy way. A department might not invest in future capability if there is any lack of clarity about the principles and processes of potential competition with alternative providers of some, or all, of its

¹⁵⁴ Graham Scott, Ian Ball and Tony Dale, "New Zealand's Public Sector Management Reform: Implications for the United States", *Journal of Policy Analysis and Management*, Vol 16, No 3, 1997.

outputs. Market-testing and contracting-out are techniques that have been used very extensively in Australia and the United Kingdom and there is much that can be learned from these countries about mistakes made and things to avoid and the practicalities of using these techniques effectively.

THE PLACE OF OUTCOMES IN PERFORMANCE SPECIFICATION

From the time that the Public Finance Act was passed in 1989, performance specifications for chief executives were required to include statements of the outcomes that justified the expenditures on outputs. This aspect of management reform has not yet realised its full potential. The conceptualisation of how this was to operate in practice was weak and the necessary policy development and management processes were not widely instituted. A useful beginning was made, and in some cases a strong organisational orientation towards outcomes is in evidence. But, overall, there is much to be done to strengthen the place of specified outcomes in public management performance agreements as an augmentation of the monitoring system.

Experience with specification of outcomes

The attempt by chief executives to incorporate outcome statements, in association with all output classes, into their performance agreements has had a mixed record. This is partly because the statements were required to be comprehensive when the system was first introduced, whereas the underlying reality was that many of the activities of government departments had not been thought about or reconsidered in terms of modern policy analysis in a long time. The outcome statements that accompanied many of the activities were general and perfunctory, such as those set out below:

Government Outcomes

The Government's desired outcomes for the transport sector in the 1995/96 year were:

- a safe, sustainable transport system at reasonable cost
- enhanced economic, social and environmental well-being.¹⁵⁵

In other areas where the policies were more coherent and the analysis had been done, it was possible to write statements that were informative and

¹⁵⁵ Ministry of Transport *Annual Report*, June 1996.

potentially useful considering the value of the associated outputs, such as those set out below:

Minister's Outcomes

The Minister's Outcomes for 1994/95 to which the Ministry for the Environment contributed were:

- Protecting indigenous habitats and maintaining biological diversity.
- Reducing the risks posed by pests, weeds and diseases to ecosystems, human health and economic production.
- Maintaining and enhancing soil quality and securing viable land use options by preventing irreversible land degradation.
- Managing the quality and quantity of water so that it can meet the future needs of ecological systems, communities (including Maori), agriculture and industry.
- Conserving and managing New Zealand's fisheries for the benefit of all New Zealanders by providing for sustainable utilisation of fisheries resources.
- Managing pollution and waste and thereby reducing risks to environmental quality and public health.
- Managing hazardous substances to reduce risk to the environment, people and the economy.
- Managing sustainably the environmental impacts of energy production and use.
- Helping to stabilise atmospheric concentrations of greenhouse gases in order to reduce risk from global climate change.
- Helping to constrain peak levels of ozone destruction and helping to achieve the full recovery of the ozone layer.¹⁵⁶

A form of presentation that articulates well the relationship between the services (outputs) provided by departments and the government's outcomes is that presented in the 30 June, 1997 Estimates of Appropriation, as set out below.

¹⁵⁶ Ministry for the Environment *Annual Report*, June 1995.

TABLE 7.1: 30 June, 1997 Estimates of Appropriation

Vote Customs

Links between Government's Strategic Result Areas and Vote Customs Output Classes and Service Delivery Goals

<i>Government's Outcomes</i>	<i>Vote Customs Output Classes and Service Delivery Goals</i>
<i>Maintaining and Accelerating Economic Growth</i>	
<ul style="list-style-type: none"> • With a particular contribution to maintaining tax policies that support the income, employment, fairness and growth objectives of the Government through a broad-based, low-rate tax system. 	<ul style="list-style-type: none"> • Checking and clearing import and export entries. • Commercial audit. • Trade and business facilitation and advisory services. • Investigating Customs offences and related legislation. • Processing Crown receipts. • Assisting industry (manufacturers, im-porters and exporters) to exploit new and existing opportunities for goods and ser-vices in local and international markets. • Preserving the tax base and encouraging compliance.
<i>Enterprise and Innovation</i>	
<ul style="list-style-type: none"> • With a particular contribution to: <ul style="list-style-type: none"> – developing policies that promote the open flow of goods, services and ideas between New Zealand and other countries and that contribute to the most efficient level of international investment; – developing and implementing programmes to enhance the performance and capabilities of small-to-medium-sized businesses. 	<ul style="list-style-type: none"> • Checking and clearing import and export entries. • Trade and business facilitation and advisory services. • Assisting industry (manufacturers, importers and exporters) to exploit new and existing opportunities for goods and services in local and international markets.

TABLE 7.1: (continued)

Community Security

- | | |
|---|--|
| <ul style="list-style-type: none"> • Particularly in the context of Customs' responsibility for border management. | <ul style="list-style-type: none"> • Checking and clearing passengers and craft. • Surveillance and search for prohibited items. • Checking and clearing import and export entries. • Investigating Customs offences and related legislation. • Registration and licensing. • Ensuring safe and secure borders with minimum intervention to legitimate trade and travel. |
|---|--|

Protecting and Enhancing the Environment

- | | |
|--|--|
| <ul style="list-style-type: none"> • Particularly in the context of Customs' responsibility for managing, at the border, the flow of environmentally harmful goods. | <ul style="list-style-type: none"> • Checking and clearing passengers and craft. • Checking and clearing import and export entries. • Investigating Customs offences and related legislation. • Surveillance and search for prohibited items. • Registration and licensing. • Ensuring safe and secure borders with minimum intervention to legitimate trade and travel. |
|--|--|

External Linkages

- | | |
|---|---|
| <ul style="list-style-type: none"> • Particularly in the context of Customs' contribution to the trade policy development process, partaking in international fora and progressing initiatives that facilitate the flow of goods at the border and assist in maximising regional trade opportunities, particularly in the wider Asia-Pacific region. | <ul style="list-style-type: none"> • Trade and business facilitation and advisory services. • Other resources associated with this activity are treated as support and are allocated across all output classes. |
|---|---|

Source: Estimates of Appropriations for the Government of New Zealand for the year ending 30 June, 1997.

The linkages between outcomes and outputs in many policies are not at all clear. Some of the activities of government may be contributing in a more general way to the government's strategic goals but they are not easily connected to an outcome statement that is particularly useful. An example is

the contribution of the former Department of Survey and Land Information to the government's desired outcomes in terms of economic and social development. It was stated in the outcomes that the clarification of titles to property contributed to economic development because it made transactions in property more efficient. This is undoubtedly true, but the outcome statement gave almost no guidance to decision makers as to its priority in terms of competing resources. Neither did it give guidance as to whether too much or too little of it was being done, nor how the outcome statement could be used as a basis for considering more efficient ways of achieving the goal.

Usually, outcomes have several contributors and no one organisation is the sole influence. There are, however, degrees of influence that an organisation can have over particular outcomes. These range from considerable influence to a small degree of influence. For example, a hospital can have considerable influence over the result of a patient's hip operation through the quality of its care. A hospital can have a small degree of influence over the road toll through the quality of its accident and emergency services. Other contributing factors to outcomes are the safety of cars, laws on road safety, the quality of roads, weather, enforcement activity, the availability of emergency ambulance services and other things.

While outcomes are the ultimate purpose of government intervention, they are not often well suited on their own to provide the basis for a performance management system in which managers are to be given greater freedoms but held to account for the use of those freedoms. More concrete specification than outcomes is generally needed for the guidance of departments and the outputs serve this purpose. Lower level outcomes are more controllable by an organisation, for example, the outcome of a patient's hip operation. To best serve the relationship between minister and manager, the manager should be held to account for delivering the outputs and lower level outcomes but also should be incentivised to perform in terms of the high-level outcomes. In each area of service, judgements need to be made on which outcomes are suitable for external accountability and which are suitable for accountability within an organisation.

A management system that emphasises accountabilities must avoid specifying performance in terms of goals over which the manager has little or no control. For this reason the accountabilities of chief executives were defined to exclude matters over which they had little or no discretion. So, for example, the commissioner of Inland Revenue is not held accountable for the level of tax revenues, because the key determinants of the level of tax revenues are the tax rates set by legislation, the tax base, and the performance of the economy. The influence of high-level outcomes has been

acknowledged, however, in both the Inland Revenue Department and the Treasury in statements about the outcomes that are sought through tax administration and policy respectively. The evaluation of effectiveness in these terms takes place through the processes of policy development and review. By contrast, there are countries where revenue authorities are rewarded according to collections because large amounts of revenue are lost through lax administration and corruption, which managers can influence.

Strengthening the outcome focus of government involves improvements in policy analysis, evaluation and strategic goal setting. Outcomes must be clear and should provide the context for the outputs specified in the accountability documents. Where lower-level rather than broad high-level outcomes can be specified clearly and measured, and where they are under the significant influence of a manager, they can be incorporated into the formal performance specifications of a department. In the evolution of a management system, it is possible to move from using only outputs to developing outcome targets. This is not a reason for abandoning the use of management information on what services are produced for what cost. The consideration of outcomes, backed by sound policy and evaluation, adds a dimension to the relationship between ministers and managers – a clearer assessment of what value the outputs have. Outcomes provide motivation for managers to seek greater effectiveness over time.

To take an example of a possible use of an outcome, it is better to set incentives for managers of a public health programme concerned with breast cancer to reduce the death rate from breast cancer (an outcome) than to screen women for breast cancer (an output). This encourages the programme managers to research the causes of the cancer and the characteristics of those most at risk, and to identify the most cost-effective interventions. Using the breast screening output as a performance incentive would encourage managers to screen as many people as possible and focus on those who are easier and cheaper to reach. Over time, information would accumulate about the marginal impact on the outcome of extra spending, and there are technical methods to assess the benefit per dollar at the margin of this public health programme in comparison with the benefit per dollar of other programmes.

Even in this apparently simple example, there are complications about holding managers to account for the outcomes. The connection between outputs and outcomes is not entirely clear except in the sense of statistical inference. Difficult financial and ethical issues emerge when the sampling process inevitably determines which cohorts in the population will be the focus of screening, thereby leaving at-risk individuals who might have been

saved by screening but who are in a low-risk cohort of the population. Some people get false results from the screening or end up with treatment that leaves them in a worse situation than they might have been in without the screening programme. These complexities in the linkages between outputs and outcomes add weight to the argument for increasing managers' attention to outcomes and to considering these questions in depth.

Outcomes should not only influence the outputs, they should be intertwined in the culture of public institutions. The focus on outcomes needs to be strengthened across the government but it should be in addition to the output-oriented performance management system, not a substitute for it. The possibilities that the two can come into conflict are discussed below.

Government and parliament should emphasise the need for departments to develop and present their business plans in ways that offer clear information on the benefits of their services in terms of outcomes. Outputs and lower level outcomes need to be linked to the government's desired outcomes. Governments in the 1990s expressed these as strategic result areas (SRAs) and departments responded by developing key result areas (KRAs). They did not always link their outputs to these SRAs and KRAs. The budget document has a section where links between outputs and outcomes are stated. However, these linkages have tended to be assertions rarely backed by substantive analysis. If necessary, a requirement to link interventions, including outputs, to outcomes and to back this up with analysis could become a legislative requirement. The static outcome statements that emerged after the Public Finance Act 1989 was first implemented were a useful beginning but they were not generally followed up. The outcome statements were written by the departments themselves. Outcomes should feature in the processes of strategic thinking and also in the allocation of resources and the monitoring of performance. But they are limited in their effect until there is evidence of sound policy analysis, evaluation of past performance and business plans that draw explicit linkages between the outcomes and the activities that departments are funded for.

Focus on outcomes

A few critics have raised concerns that the focus to date that is primarily on outputs may be a source of bias against the ownership and outcome dimensions of the specification of performance. Schick, for example, says:

The New Zealand version of accountability currently has more to do with purchase than with ownership, more with producing outputs than with the overall capacity of the department, more with whether managers are meeting specified targets than with whether public programmes are effective. Policy

outcomes are outside the managerial accountability framework; they are considered matters of ministerial responsibility and political judgement.¹⁵⁷

There is no bias inherent in the management system itself if outputs and outcomes are used appropriately, and the system evolves towards more emphasis on outcomes in two ways. The first is the increasing understanding of the links between outputs and outcomes, which enables agencies and ministers to understand the best mix of outputs to achieve the outcomes sought. The second is a more direct use of outcomes in performance specification, where they are able to be clearly specified and where managers can significantly influence them.

There is some justification for Schick's criticism. Also, David Osborne,¹⁵⁸ the co-author of the book *Reinventing Government*, has challenged New Zealand's public management to reinvigorate the quest for greater outcome orientation. New Zealand's progress towards outcomes has been slow. Ministers have often not engaged their departments in dialogues about outcomes. Policy analysis and evaluation has been weak in many areas. The failure is not too much focus on outputs, rather it is too little focus on outcomes. No systematic survey of the use of outcomes in New Zealand's public management has been conducted. However, the record shows some promising examples, as can be seen in a paper by the Treasury.¹⁵⁹

Achieving outcome goals is not easy, however, and raises possibilities of distortion to incentives if not done carefully and within a framework of management that identifies and manages this risk. Managing to achieve outcomes is a process of experimentation, information gathering, evaluation and continual modification of approaches to service delivery. It is about innovation and organisational learning and it will not happen in a traditional bureaucratic organisation or poorly managed modern public organisation.

¹⁵⁷ Schick, *op cit*, p 73.

¹⁵⁸ David Osborne and Ted Gaebler, *Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector*, Plume, New York, 1993; Osborne and Plastrik, *loc cit*. Osborne made this challenge in a speech at Victoria University of Wellington in November 1999.

¹⁵⁹ Andrew Kibblewhite and Chris Ussher, *Outcomes Focused Management in New Zealand*, The Treasury, 2000.

The American approach

It is interesting to reflect on American experience in the light of the US Government Performance and Results Act 1993 (GPRA). This is the most ambitious attempt to commit a government to management by outcomes of any country so far. It was implemented during the year 2000 when each federal agency was expected to report on an outcome basis.

There has been a concern for the development of outcome-based approaches to management that goes back 20 years or more. The examples that abound in the American literature are from state and local governments where applying management based on outcomes to the services selected was relatively easy. An example is contracting for clean streets. In recent years attention has expanded to the more difficult areas. The Internal Revenue Service, Customs Administration and others have been at the forefront of outcome-based developments and have produced substantial service improvements. The evidence from experiments with using outcomes as performance goals in complex and sensitive policies is still mixed. For example, the state of Florida was highlighted by the senate committee in the federal government that developed the GPRA as the best example in the United States available in 1993. In particular a programme for assisting children at risk of abuse in families was seen as a path-breaking model. However, within 12 months and the arrival of a new state governor the programme was abandoned.

Evidence is now emerging about how the US government proposes to deal with the uncertainties surrounding the use of outcome information in isolation from information about outputs, particularly where the outcome information is vague and policy analysis is not strong. The first examples used a planning approach similar to what has emerged in New Zealand, in the form of strategic business plans. These traced the linkages from organisational mission statements and objectives through to statements of outcomes that were associated with outputs. The example below comes from the US Occupational Safety and Health Administration of the Department of Labor. Extracts from its strategic plan for the years 1997 to 2002 appear in the following tables:

TABLE 7.2

United States Department of Labor Occupational Safety and Health Administration Strategic Plan
FY 1997 – FY 2002

I. Mission

In 1970, Congress established the Occupational Safety and Health Administration (OSHA). As defined in its enabling legislation, P.L. 91-596, the Occupational Safety and Health Act of 1970 OSHA's mission is to "Assure so far as possible every working man and woman in the Nation safe and healthful working conditions." This mandate involves the application of a set of tools by OSHA (e.g, standards development, enforcement, compliance assistance) which enable employers to maintain safe and healthful workplaces.

II. Vision

OSHA's vision is to be a world class leader in occupational safety and health by making America's workplaces the safest in the world. OSHA is striving for the elimination of workplace injuries, illnesses, and deaths so that all of America's workers can return home safely. To support this vision, workplace environments must be characterized by a genuine, shared commitment to workplace safety and health by both employers and workers, with the necessary training, resources, and support systems devoted to making this happen.

In light of this vision, OSHA will be a results-oriented agency, using data proactively to identify workplace safety and health problems and apply a comprehensive strategy that combines common sense regulation; a firm, fair and consistent enforcement policy; and wide-ranging approaches to compliance assistance that meet the needs of workers and employers and effectively use the nation's resources.

Source: Table 7.2 and 7.3, Strategic Plan, Occupational Safety and Health Administration, United States Department of Labor, FY 1997-2002. Departmental version, 30 September 1997.

TABLE 7.3

<i>Departmental Goal:</i>	Safe, Healthy and Equal Opportunity Workplaces
<i>Agency Strategic Goal (1):</i>	Improve workplace safety and health for all workers, as evidenced by fewer hazards, reduced exposures, and fewer injuries, illnesses, and fatalities.
<i>Performance goals/objectives (outcomes):</i>	
<ul style="list-style-type: none"> • By FY 2002, reduce the number of worker injuries, illnesses, and fatalities by focusing nation-wide attention and Agency resources on the most prevalent types of workplace injuries and illnesses, the most hazardous industries, and the most hazardous workplaces, as evidenced by: <ul style="list-style-type: none"> – Reducing three of the most prevalent types of workplace injuries and illnesses by 15% by focusing on those industries and occupations that cause the most injuries/illnesses and pose the greatest risk to workers – Reducing injuries and illnesses in at least 5 high hazard industries by 15%, by focusing on those workplaces with the highest injuries and illnesses – Decreasing fatalities in the construction industry by 15%, by focusing on the four leading causes of fatalities (falls, struck-by, crushed-by, and electrocutions and electrical injuries) – Effecting at least a 20% reduction in injuries and illnesses in at least 100,000 workplaces where the Agency initiates a major intervention – Within four years of the effective date of significant final rules, achieving a 20% reduction in fatalities, injuries, or illnesses, or, for program rules or revisions, a 20% or greater increase in the rate of current industry compliance. • Respond effectively to legal mandates, so that workers are provided full protection under the OSH Act, as evidenced by: <ul style="list-style-type: none"> – Initiating inspection of fatalities and catastrophes within 1 working day of notification for 95% of occurrences to prevent further injuries or deaths – Initiating investigation of worker complaints within 1 working day or conducting an on-site inspection within 5 working days, so that eighty percent (80%) of all worker complaints that require on-site inspection are resolved within an average of 20 working days of notification to the employer, by FY 2000** – Evaluating and, if necessary, revising the 11© “whistleblower” program – By FY 2000, resolving 75% of all whistleblower cases within 90 days. 	

TABLE 7.3 (continued)

How will you accomplish these performance goals/objectives (outputs)?

- Problem Analysis
- Standards Promulgation
- Enforcement
- Compliance Assistance and Partnerships
- Training and Education
- Information Technology
- Management Systems

Section X of this Plan provides a description of these Strategic Tools

** OSHA offers workers the choice between two approaches to handle their complaints – either OSHA will contact employers via phone/fax to inform them of the complaint, with a response required back from the employer within five (5) working days, or OSHA will conduct an on-site investigation. Also note that a percentage of worker complaints identify hazards that necessitate considerable changes to engineering control systems and may require a longer time period for the complete abatement of the hazard.

The outcomes set out on the preceding page include a mixture of outputs (including quality measures for these), inputs and outcomes in the New Zealand terminology.

There is a convergence between the New Zealand and US approaches toward a single business plan that links management performance goals to the budget process and to performance goals in outcome terms. Through this technique practical managers have bypassed an increasingly sterile debate among theoreticians. The strategic business plan is a management tool for putting into one accountability document goals that are practicable and achievable. The business plan also contains commitments about what is to be done to achieve them plus other pertinent information about factors in the external environment surrounding the organisation or within it that will impact on the probabilities of success of achieving the performance goals.

The experience of GPRA in the United States shows, in my view, that the attempt to commit an entire government to outcome-based performance accountability is problematical. The practicality of implementation forces the use of proxies for outcomes and measures of activity that result in a situation that is very close to an output-oriented system that is augmented by measures and indicators of outcomes.

A decade of experience across countries at the leading edge of public management leads me to the conclusion that outputs are superior to outcomes as the tool for linking the management plans of public

organisations to the processes of budgeting and financial accountability, both between the executive and the parliament and within the executive. This provides the platform on which a renewed focus on outcomes should be built where outputs are linked to outcomes.

A lesson we can learn from the United States is that public institutions will take outcomes seriously if they are directed to. A legislative change in New Zealand that reinforces the commitment to outcomes could help to launch a new thrust in this direction. The language of that legislation should be carefully crafted to allow for the reality that introducing outcome measures and indicators will be piecemeal and should be done in addition to outputs in many, if not most, circumstances.

CONCLUSIONS

In the New Zealand public management system the procedure of management delegation rests in part on the accountability of chief executives to meet well-specified performance goals. The degree of delegation would be hard to justify without such goals. Improving the performance of public organisations depends on finding practical approaches to managing for better results, and this cannot be done without being clear what results are required. Performance specifications also have important implications for governance.

It is not possible to assert that there is something inherently good or bad about a particular means of specifying performance without examining the relationship between the parties to the performance agreement and the decision rights and accountabilities the performance agreements carry. The best method of performance specification is the one that most efficiently serves that relationship. The model needs to be designed to serve a range of relationships, but there has to be a degree of standardisation, in the interests of having efficient budgeting, planning, management and monitoring processes at the level of the whole of the government. The government must have a system-wide basic concept of performance that promotes comparability between different parts of the government and uniformity to the budgetary process. This also assists with accountability to the parliament and the wider community.

Performance concepts should be adapted and improved continually in the search for lower administrative costs and better alignment between the goals of government and the incentives of public organisations. There is a theoretical cost in the specification of performance that optimises the net benefits. Beyond this point the transaction costs and deadweight costs of

de-motivated managers, incentives based on phoney accuracy, and rigidity in the system will cause performance to deteriorate. There is no systematic evidence to suggest that departments have generally reached this point, although the SSC's studies show that some Crown entities were well short of it. Some prices and volumes for outputs are inaccurate and some performance specifications have produced distortions in practice. The government should continue to strengthen and develop its output-based management system. The clarity of performance expectation and subsequent accountability that comes with the output focus has yielded significant benefits. There are, however, weaknesses in this system and there is the perennial tendency for any public sector management system to go slack. Evidence of this can be seen in poor departmental performance specification.

Outputs must be clearly defined, deliverable and capable of assessment in that regard. They must be priced with robust transparent systems of cost accounting and be benchmarked. They must be tightly linked to the budget and internal management on the one hand and the government's strategic objectives on the other. They should be a concrete component of the evaluation of the policy programmes that they relate to.

Outputs can be augmented by the use of lower-level outcomes. The links should become increasingly clear between an organisation's outputs and lower-level outcomes and between these and the government's high-level outcomes. This requires examination, evaluation and the provision of sound policy advice.

Transparency in the relationships between ministers, civil servants, the government and parliament about the performance of the government and how it uses its resources is strongly influenced by the way performance is specified and reported on. The decentralised management system depends critically on well-specified outputs to ensure the accountability of managers and to link operational management with the government's budget and parliament's monitoring of the executive.

The strengthening of the output system requires action in a number of areas:

- high-quality goal setting in the form of outcomes by the government that ministries and departments can link their interventions to, including their outputs;
- greater support for ministers in their role as active, discriminating purchasers of departmental outputs;
- more emphasis by the SSC on linking the performance on outputs to the assessment of chief executives' performance. This should be done

through the reporting of compliance with purchase and performance agreements and possibly, by exception, reporting as a context for the assessment on the achievement of major goals by chief executives as discussed in chapter nine;

- greater attention to policy work to provide information on the effectiveness of outputs in outcome terms;
- continued attention to the quality of output specifications – to enhance the initial specifications and to prevent deterioration in the quality of specification;
- clearer allocation of monitoring responsibilities for output monitoring and more active monitoring;
- development of the output pricing methodologies;
- greater attention to output costing via the audit process;
- ensuring that detailed budget decision-making is made with good output information; and
- further development and strengthening of the links between outputs and strategic goal setting, budgeting and policy evaluation on the one hand and internal management on the other. (These matters are taken up in chapter 11.)

While there are good examples of outcome-based approaches to management to be found through the government a much more consistent and soundly based policy is needed across the whole of government.

APPENDIX: EXAMPLE OF AN OUTPUT FOR LAND TITLES

<i>Output</i>			
Provision of services to register and record land title information and provision of public access to the data			
<i>Performance measures</i>		<i>1999 actual performance</i>	<i>2000 expected performance</i>
<i>Quantity</i>	1 Transactions processed	730,252	720,000 – 750,000
	2 New titles issued	56,245	54,000 – 60,000
	3 Plans deposited	20,121	18,000 – 24,000
	4 Title searches provided	861,232	857,000 – 865,000
	5 Guaranteed search notes	170,435	168,000 – 175,000
	6 Document searches provided	245,678	242,000 – 248,000
	7 Plan copies provided	56,987	54,000 – 59,000
<i>Quality</i>	All work to meet legislative standards and Registrar General's standard manuals – checked by annual independent audits on each of 1–7 above against the legislative and standard manual requirements	Full compliance for 1–5, 7. Compliance errors for 6 noted and action plan developed	Full compliance
	Percent of customers in annual satisfaction survey who considered expectations substantially met (survey conducted by independent organisation)	85%	90%
<i>Timeliness</i>	Meet timeliness standards required by legislation and Registrar General's standards manual – checked by audit referred to above	As above	As above
<i>Location</i>	Internet access	For title and document searches	For 20% of transactions as well as title and document searches
	Services provided from offices located in five main centres	All services	All services
<i>Cost</i>	Cost [note – detailed unit costs also available]	\$1.2m less fees \$200k – total cost \$1m	\$1.2m less fees \$300k – total cost \$900k

Link to government goal – outcome

Government goal of clearly defined, marketable and secure land property rights, and maintenance of the resulting records to underpin economic activity.

Note: this is a fictional output for illustrative purposes only.

OWNERSHIP INTERESTS: PERFORMANCE EXPECTATIONS FOR ENHANCED ORGANISATIONAL CAPABILITY

INTRODUCTION

Governments need a capable administration to execute their policies. The government should be concerned to ensure that each department or entity is looking to the future, enhancing its organisational capability and improving its ability to deliver services in the future. High levels of current capability and investments in policy and management capacity help to ensure the satisfactory production of outputs in the future. The government's ownership interest can be viewed as the capitalisation of future purchase interests in an uncertain world, which is a form of risk management.

This chapter considers the distinction between the ownership and purchase interests made in the Public Finance Act 1989. It discusses three important aspects of ownership interests, capability, the power to direct and the location of residual rights and obligations.

Particular areas for improvement in the specification and monitoring of ownership interests are raised. These centre on the specification and management of human and intellectual capital, the need to develop useful indicators, the potential for more attention to quality improvement, and some weaknesses in the way the monitoring agencies have approached their work.

A CONCEPTUAL NOTE ABOUT OWNERSHIP

The Public Finance Act 1989

The Public Finance Act 1989 introduced a partial distinction between the purchase and ownership interests in so far as these are captured in accounting numbers. This is accomplished by requiring the generally accepted accounting principles to apply to the government. According to these principles, it is necessary for departments, Crown entities and SOEs to report the revenues on an accrual basis, not just the cash figures associated with the delivery of current services. This covers the full costs of output production, which is an element of the government's purchase interest. Also

required is a statement of financial position, which captures the assets and liabilities of the department. These represent expenditures on items that will be available for the production of outputs and commitments that will have to be met in the future. Taken together, they provide an estimate of the financial dimensions of the government's ownership interest in the department, Crown entity or SOE.

Aspects of ownership

The concept of the government's ownership interests in public organisations has become commonplace in discussions on public management. The notion of a government owning an organisation captures the powers it has to direct its activities and invest and dis-invest in its assets. These rights rest in statute and convention. In the case of state-owned enterprises and Crown-owned companies, the concept of ownership is largely defined under company law. For Crown entities that are not incorporated under the Companies Act 1993 and for departments and ministries, the ownership rights are based in the general law and conventions.

A government must be concerned about its investment in these agencies and whether to invest or dis-invest in them. This is why the appropriation acts distinguish between funds to purchase services and funds to invest in the capabilities of agencies.

The government's ownership interest has three dimensions. The first is a concern for the capability of government organisations to deliver services in the present and future years. The second aspect is the rights of direction by ministers. The third aspect is the rights to residual surpluses or the obligation for residual claims.

The capability of government organisations can be assessed in many ways. This includes the views of ministers, evidence of performance and non-performance, and benchmarks against indicators related to human resources, intellectual capital, physical assets, information management, financial management, compliance behaviour and risk management. The government is interested in the efficiency with which these resources are being applied to delivering the current services. Because there is uncertainty about what services will be required in the future, the presence in a department of a healthy capability, and plans to maintain it, provide the government some assurance against the risk of provision of inadequate services in the future. Hence, the ownership interest is more important in situations where there are few or no practical opportunities to acquire the services in question by contracting out to other suppliers.

The second aspect of ownership, the rights of ministers to direct organisations, varies according to the law associated with the organisation. For most government departments, the right is largely unfettered except for employment matters in the realm of chief executives' authorities under the State Sector Act 1988. For some departments, the ministers' rights are constrained, for example, organisations headed by statutory officers appointed by parliament, with duties to the parliament prescribed in legislation. In the case of the commissioner of Inland Revenue, the parliament has prohibited the government from exercising its normal rights as owner to direct the organisation in respect of individual taxpayers.

A third dimension of government ownership is the right to residual surpluses or the obligation to meet residual claims. With regard to the latter, there has been a history of failure of the government in taking proper account of these. The government has an interest in ensuring that its agencies are not incurring actual or contingent financial risks that will rest on the government's consolidated financial statements and possibly be a claim on future government resources. The allocation of residual claims around the 'think big' projects provide prominent examples. These large-scale projects in energy development, sponsored in the early 1980s by the government, all collapsed financially when the oil price fell. The government faced six billion dollars of write-offs as the holder of residual claims arising from various guarantees and other forms of support.

There is a lack of clarity over residual rights in some areas. The long-running debates over university governance are an example. The ambiguous rights of the government to residual control over assets, coupled with the government's ability to avoid an implicit underwriting of the universities' financial risks, results in an unusual set of murky ownership rights and confusion in governance.

ACCOUNTING FOR HUMAN AND INTELLECTUAL CAPITAL

The major factors affecting the organisational capability of a government department or Crown entity are its human capability and its intellectual capital. These elements are not captured in conventional financial reports.

Human capital

There are accounting techniques that endeavour to account for investments in human capital. They record expenses in recruitment and training and there are rules for whether this is expensed in the period it is incurred or

spread over multiple periods. However, the department or entity does not 'own' the asset created by such investment because it becomes embodied in the person of the recruit or trainee. Essentially, the department rents the asset it purchased through the wages that it pays. Modern accounting does capture future liabilities to staff for pensions, however, and is superior to purely cash-based systems in spite of its shortcomings.

Insufficient attention has been paid over many years to assessing the enhancement of the human capability of government departments in particular. This has been a significant oversight. Anecdotal evidence suggests that there has been inadequate investment in human capability but without more information it is hard to be sure. The problem may be that the government is just not prepared to pay the going rate for human capital that is readily available at a price.

Templates of indicators could be used to promote the assessment of the performance of chief executives in developing human capital assets. The SSC has made a useful contribution to this in their occasional paper.¹⁶⁰ Chief executives could develop expected benchmarks for indicators relevant for their organisations and could track performance. This would help ministers, monitors and departments themselves to reach a sound judgement as to whether the department is clear about what human resource capability it needs to perform its mission, what it will need in the future, and whether the department is succeeding in providing for those requirements.

Measurements based purely on expenditure on the development of human resources could lead to undesirable results. This could be counteracted through instruments that assess the human capability on a number of dimensions. While formal training activities would form a part of this, it is well known that organisational effectiveness is greatly influenced by on-the-job training and advanced practices in personnel management. Over time, the development of these instruments would encourage better practices in the management of human resources and would also highlight those activities most successful in building capability.

The alignment of the human resource policies and practices of a department with its overarching strategic goals is a necessary condition for success. Some New Zealand experiences suggest that the key cause of

¹⁶⁰ State Services Commission, *Measuring Human Resource Capability in the Public Service*, Occasional Paper No 13, August 1999.

differentials in performance between departments may be the human resource strategies. Over a long period of time, the Treasury and the Ministry of Foreign Affairs and Trade have dominated their respective areas of policy and both have had a long tradition of recruiting and developing highly skilled staff. The turnaround in the performance of the Department of Social Welfare over some years was coincident with a refocused effort in management and human resource development.

There are serious weaknesses in the capacity for good quality policy advice in some important areas of the government. Not enough has been done to address the problems of staff skills, complementary resources and organisational culture in some ministries. The SSC needs to be more forceful in addressing these areas of weakness.

Organisation-specific human capital

It is useful, when designing systematic approaches to the management of human capital, to draw the distinction between generic human capital and organisation-specific human capital. The first represents the value that an employee has as a result of the knowledge and skill that they could transfer to another organisation, while the second assesses their value within a particular organisation as a result of having worked there for some time. For the private sector, estimates of this margin show it to be large and that it is measured by tenure-related pay differentials and by the drop in wage rate when employees who have worked with one employer for a long time are laid off and take a job with a new employer.

Specific capital arises from the development of the joint relationship between employer and employee and it is lost when the relationship is ended. Because it arises over long periods of time, it is not possible to write long-term contracts that are specific enough to capture the mutual benefits without exploitation. Instead convention and implicit unwritten contracts arise around it. These are captured in the reputation of organisations as employers, or may be captured in external norms, laws and conventions about good employer behaviour.

The concept of human capital being specific to organisations offers practical insights to human resource managers when thinking about maintaining and growing the capability of public institutions. It could help, for example, to think about building career paths and avoiding the dumbing down of policy capability that follows from the high turnover of analysts.

Managing intellectual capital

Public institutions commonly require assets in the form of intangible intellectual capital. The creation and management of these assets has been critical to the success or failure of policy departments in particular, although such assets exist in all departments in one form or another. The traditional departmental filing system has been the repository of much intellectual capital. The commonly used term 'institutional memory' in relation to a public organisation is also a reference to intellectual capital in some of its dimensions. The term has been used most prominently by people concerned that the restructuring of the public sector, layoffs, the fixed-term tenure for top managers and other forces may have erased the ability of departments to draw on their history and experience in making decisions and in giving advice today.

The public sector has, in general, been less focused on the issues of management of intellectual capital than has the private sector. The fact that intellectual property is not generally protected in the public sector, except perhaps for user charges in some cases, is one reason why departments have not developed sophisticated systems for managing intellectual capital. There has not been the same concern in this sector as there is in the private sector to define the property with a view to protecting it from competitors. The issues of efficiency in investment and use of intellectual capital, however, should be equally relevant in the public sector. There are also increasing numbers of issues around the protection of public sector intellectual property. For example, some government agencies have been selling advisory services and proprietary information technology internationally.

It is currently fashionable in the private sector to believe that the global economy has allowed the forces of competition to undermine the traditional sources of sustainable competitive advantage. According to this view, access to raw materials, labour, machinery and technology is no longer enough for a firm to rely on as a permanent basis for sustaining its market share. The development and protection of intellectual capital may, however, be a more sustainable basis on which to compete. Hence the explosion of books, articles and consulting firms on the subject. As with any fad, much of the literature is rudimentary, at least in its 'airport bookstore' form. The subject is more serious than that, has been around for a while, and warrants serious attention by managers in the public sector.

At this stage there are no widely accepted concepts and methods that could be adapted for use in departments, ministries and Crown entities. There are some useful insights from the literature, and case studies are

emerging of companies that have developed successful techniques for defining, building, managing and protecting intellectual capital.¹⁶¹ Each government organisation needs to work through a process of:

- identifying the significant goods and services they must deliver now and into the future;
- understanding what inputs, systems and processes they need to ensure they can deliver those goods and services;
- identifying useful measures that indicate how well they are operating their systems and processes and utilising and developing their assets for the future; and
- measuring, reporting, monitoring and adjusting their operations in response to the information on key indicators.

Some New Zealand government departments have long had systems that work well in particular areas although they are not seen as a component of a comprehensive approach. It would be worthwhile for Treasury, the SSC and a department with a strong reliance on intellectual capital to co-operate in a survey of the field. The numerous methods and checklists for assessing human and intellectual capital assets in the emerging literature may provoke useful insights. They might suggest methods that could be adopted to enter this class of asset into the management and assessment of institutional performance.

MONITORING OWNERSHIP PERFORMANCE

The original template for the performance agreements of chief executives included a section on ownership issues. The conceptual work on how it

¹⁶¹ Thomas AA Stewart selection of books on the subject without specific recommendations follows:

Intellectual Capital, the New Wealth of Organisations, Doubleday, New York, 1997.

Leif Edvinsson and Michael S Malone, *Intellectual Capital: Realizing Your Company's True Value by Finding Its Hidden Roots*, Harperbusiness, New York, March 1997.

Karl Erik Sveiby, *The New Organizational Wealth: Managing & Measuring Knowledge-Based Assets*, Berrett-Koehler, San Francisco, April, 1997.

Annie Brooking, *Intellectual Capital*, Thomson Learning, 1995.

Thomas H Davenport and Laurence Prusak, *Working Knowledge: How Organizations Manage What They Know*, Harvard Business School Press, December, 1997.

Warren Bennis and Patricia Ward Biederman, *Organizing Genius: The Secrets of Creative Collaboration*, Perseus Press, June, 1998.

should be done was completed, and methodologies were developed and implemented in 1989–90. It was subsequently abandoned under the National government. The 2000/2001 performance agreements have a section for ownership requirements with some guidance on what to consider. This includes:

- strategic alignment to the government's priorities;
- integrity and commitment to the collective interest and public service values;
- future capability;
- long-run cost effectiveness by producing specified outputs at the lowest price consistent with maintaining long-term viability.

There has been persistent comment, such as emerged in Allen Schick's report, that the ownership interests of the government have not been given sufficient emphasis. I agree that this aspect of the management system is not working to the standards required of it.

Schick asserts that there is an inherent tendency for the purchase interest to drive out the ownership interest. He links this tendency to a focus on contracting for outputs. Schick hints that the minister should be made a 'somewhat less independent purchaser of outputs' as a solution. He does not provide a reason why this would increase the focus on ownership, and in fact the reverse is likely to be the case. The ownership interest is about the capacity of a department to deliver outputs in the future. Therefore a minister would be less interested in the ownership issues if they did not expect to have a lot of influence over what those outputs will be. As Schick says:

... a minister is more effectively empowered by having a robust department than by having the option to contract for outside advice and other services.¹⁶²

Some experienced ministers demonstrate that they understand this. They can balance the price of today's outputs against the quality and availability of tomorrow's, and they are entitled to make these judgements. The terms of office of the senior managers in departments ensure that they will argue for maintaining the capacity of their departments. The management system should, however, ensure that comprehensive high-quality information is available to inform these decisions. This is not the case at present and it is

¹⁶² Schick, *op cit*, p 43.

premature to conclude that there are biases in the system before the quality of information is improved.

The Rt Hon Simon Upton commented at the 1999 Public Sector Management Conference that “ministers come and go and will not generally take much interest in the ownership side, chief executives will have to”. Chief executives cannot do this unless ministers provide them with the necessary resources to protect the ownership interests.

Managers and others have commented that the asset base and capability of the public sector may have been run down. Some people view the causes to be short-term fiscal stress and a lack of attention to gauging the ownership interests of the government. The evidence for this is patchy. The government has two safety valves: output pricing reviews and annual budget round proposals. There were fiscal pressures on the government in the 1990s although, since 1996, governments have injected sizeable sums into increasing government services. Problems in capability may relate more to the need to recruit and develop more highly skilled people and employ more sophisticated techniques to manage increasingly complex issues.

The responsibility for ownership monitoring work is spread around, possibly over too many players. These include the Treasury, the SSC, and the Crown Company Monitoring and Advisory Unit (CCMAU) that monitors the corporatised Crown entities and SOEs. Other monitoring functions have developed in line – ministries and organisations such as the Education Review Office. Ministries take an interest in the ownership issues of the Crown entities that operate in their policy areas. A cabinet decision in 1999 clarified that ministries should provide this monitoring service for ministers. For example, the Ministry of Economic Development has to oversee a large number of entities such as the Commerce Commission. The Audit Office undertakes periodic studies of aspects of ownership matters, such as the robustness of financial management and the governance of Crown entities.

As well as monitoring Crown entities, some ministries or departments monitor the purchase interest in linked departments. For example, the Department of Labour monitors the minister of labour’s purchase interest in the Department of Work and Income New Zealand. Having ministries monitor related entities makes sense superficially, because the minister of commerce naturally looks to the Ministry of Economic Development for advice on the organisational health of the entities included in the commerce portfolio. However, there are other factors to consider. Ownership monitoring activities have never been part of the core competence of the ministries that are tasked primarily with the supply of policy and

administrative services. The historical cultures of these ministries have never included skills in the advanced analysis of businesses that are required for making judgements about the quality of human, intellectual and physical capital, the financial health of an organisation and the quality of its management. The patterns of recruitment of staff into ministries emphasise academic and administrative skills. It is not attractive for private sector people with the skills in the ownership monitoring field to work in a backroom function inside a policy ministry. Career paths in policy ministries for people with those specialities are limited.

There can be difficulties with a ministry that monitors a Crown entity when that ministry competes with the entity in giving advice to the minister or when it seeks to take over some of the Crown entity's activities. While the relationship between the Ministry of Health and the HFA was generally very productive, elements of this problem crept in at times. The new responsibilities for the Ministry of Health, following the reforms in 2000, are interesting to reflect on with regard to ownership monitoring.

Merging the ownership interest in public hospitals with the Ministry of Health

Following the 1999 election, the government announced that it would transfer to the Ministry of Health the ownership monitoring work of CCMAU that was concerned with the government-owned hospital companies.

The Ministry of Health has not had the skills to do this work in the past and there will initially be a loss of capability through the transfer of the function. In the transition, about 80 percent of the CCMAU staff resigned. Perhaps staffing and capability can be restored and grown further in the future, but there are other difficulties that will have to be addressed first.

The Ministry of Health will take on the functions of funding District Health Boards, which will do some of the purchasing of hospital services. The ministry will also be likely to purchase national health services directly from hospitals.

How might these arrangements work out? The trade-offs that previously occurred with some transparency between the prices paid for hospital services and the financial health of the public hospitals may vanish into internal management processes in the ministry. The hospitals in their many forms over time have had a history of cost increases, often above levels of general inflation.

Prior to the 1993 reforms, Area Health Boards were responsible for hospital services through a contract with the minister of health. Many boards ran deficits and were known to have run down their assets.¹⁶³ Hospitals were corporatised in 1993 and named Crown Health Enterprises. They were given opening deficits of \$175 million which, instead of declining as planned, peaked at \$201 million in 1996/97. Costs increased above the Consumers Price Index (CPI) for five years (from 1994 to 1999). In one of these years (1996/97), the CPI rose 1.1 percent over the previous year, while the aggregate costs for CHEs increased 5.8 percent, with a revenue growth of 4.6 percent. Almost all CHEs failed consistently to perform against their business plans from the day they drew breath until today. A national pricing framework was developed for hospital services based on an efficiency analysis of all CHE services. Once work commenced on this, there was a bend in the CHE cost increases which fell from the 5 percent per year trend to 2.5 percent over the previous year. While it cannot be proved, without considerable analysis, that national pricing caused this, an informed supposition can be made that it had a significant impact.¹⁶⁴

The interest in undertaking these studies and in maintaining the national pricing work may be weak in the new conglomerate arrangements. Unless the ministry managed to impose improvements in hospital productivity, it would face the inevitable dilemma of whether to cut services to fund cost increases or to run the hospitals into deficit. The director-general's incentives would be to ask the government for more money to avoid the dilemma of decreasing services or running deficits. Such requests would not, in general, be fully met so hospital finances would deteriorate and debt ratios of hospitals would rise, relying on the fact that lenders see the debt as government guaranteed.

The minister of finance would soon react to this situation by requiring the Treasury to expand its health section to provide detailed advice on the government ownership interest in public hospitals.

¹⁶³ By 1992/93 Area Health Boards had built up an aggregate deficit of \$66.1 million after posting a surplus of \$41 million in 1989/90. Deloitte Touche Tohmatsu *Trends in Area Health Board/CHE Performance 1989/90 – 1997/98*, Wellington 1996.

¹⁶⁴ For a fuller discussion see G Scott, L McKenzie and J Webster, "Case Study New Zealand", in *Innovations in Health Services Volume 1 The Corporatisation of Hospitals*, A Harding and A Prekker (eds), World Bank, John Hopkins University Press, 2000, ch 9.

It will be interesting to see how the experiment with putting one of the Crown's ownership interests into a conglomerate sector ministry works out. I am expecting some difficulty with it.

Improving ownership monitoring

The government has to be concerned to ensure that the methods and standards of ownership monitoring work are uniformly high across the government and this may be difficult to achieve when it is so fragmented. Also, given the importance of ownership monitoring, senior ministers will want to be able to look to particular individuals to ensure that the work is well executed.

The minister of finance has responsibility for the whole of the government's balance sheet and this includes its investments in the capability of departments and Crown entities. The Treasury has competence in advanced financial analysis of the components of this balance sheet, which is epitomised by the New Zealand Debt Management Office. This part of the Treasury is the centre of the assessment and management of financial risk flowing from the government's debt and financial assets. From this core the Treasury could grow its capabilities in the technical assessment of risks that carry potential financial consequences across the government. The Treasury must also have the skills to take a view on the quality of financial management in every government organisation, so that the secretary can responsibly sign the public accounts.

The Treasury's internal organisation has merged the investigation of the purchase activity, or what is typically called 'intervention analysis', with the investigation of the ownership interest into a line of work labelled 'vote analysis'. This is a hybrid of policy analysis and ownership analysis. By doing it this way the Treasury has the advantage of providing departments with a single point of contact and an integrated line of advice. The challenge this poses for the Treasury is to bring to bear a multi-disciplinary approach. The alternative is to run the two aspects of the work from different branches of the department. There are strengths and weaknesses in both approaches. It is probably fair to say that the predominant professional culture of the Treasury, which is economics, tends to crowd out the more eclectic work on ownership issues when resource trade-offs have to be made within the Treasury itself.

Whether policy and ownership analysis are merged or otherwise, it remains important to attend to the ownership interest. The skills for doing this are not necessarily drawn from the same professional background as

those of people skilled in intervention analysis. The suggestion here for the Treasury to specialise in those aspects of ownership work that play to its comparative advantages and primary responsibilities is one way to deal with longstanding questions about the skill base needed in the Treasury. This proposal is also compatible with the proposal elsewhere in this book for reorganising the structures of policy ministries.

Other aspects of ownership monitoring such as the assessment of human and intellectual capital, information systems and other key aspects of capability centre naturally on the SSC. It has traditionally had a variety of roles in these areas, but it does not have the skill base and culture to do advanced business analysis. In a press release in September 1999, the then minister of state services, the Rt Hon Simon Upton, set out his concerns and plans for the SSC.

The new focus will see the commission charged with becoming a principal adviser to ministers on the health and capability of core government departments. The changes will require the commission to upgrade significantly its ability to provide forward-looking, pro-active advice on the ability of government departments to deliver. They are designed to arm ministers with the information they need to hold chief executives to account for their stewardship of taxpayers' resources. In turn, ministers will have to devote more attention to the 'ownership' side of their portfolios.

The severe fiscal crisis of the late 1980s properly focused the attention of ministers on gaining control of public expenditure – the so-called purchase side of the equation. As a result, New Zealand politicians probably know more than any other country about what they get for the money they spend and how trade-offs between priorities are made. It has provided us with an indispensable and formidable control over public expenditure. But ministers have been much less well-informed about the health of the ministries they deal with.

While ministers labour over purchase agreements, knowledge about the ability of departments to deliver is left almost entirely in the hands of chief executives. It is time that ministers were put in a position to seek these assurances. What parliament and the public need 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.

Moving to a forward-looking monitoring regime will require a radical shift in the commission's focus. Chief executives have to be left to manage and any suggestion that the commission should be trying to second guess them would lead to muddle and confused accountabilities. What we are seeking to do is ensure that ministers, on behalf of the 'owners' (the people of New Zealand), can

ask the sort of questions any concerned owner would want to ask. Ministers can't do that if they don't have high quality advice. The commission has to provide it.

It is surely strange that, currently, there are much more formal arrangements for monitoring the government's ownership interest in state owned enterprises than we have for government departments. Boards are appointed explicitly to monitor the Crown's ownership interest in these companies. Recent announcements have extended this approach to the governance of Crown entities. Government departments are every bit as important as Crown entities and state owned enterprises. Ensuring that they can deliver requires a fresh focus from the SSC and from ministers. It is up to the commission to prove that it can develop a dynamic, up-to-date approach to monitoring the quality of public sector management. Ministers are ready and willing to play their part.

The SSC was declared to be the principal adviser to the government on capability matters in relation to departments and ministries.

It was noted by the minister that it would take three years for the SSC to assemble the skills required to carry out this role. The commission has recently taken four steps towards improving the accountability arrangements. One is the appointment of the first of what may become several new deputy commissioners to work more closely with the chief executives. It was difficult for the state services commissioner alone to manage relationships with 36 chief executives, all ministers and the commissioner's own internal reports. The first of the new deputy commissioners has indicated a keen desire to move towards a more active engagement with departments and ministries on directions and issues. A support team of staff with management consulting skills is being assembled. This should help the commission move away from the monitoring approaches associated with the skills of civil servants, some of whom lacked the backgrounds required to monitor and interact at senior management levels. It is early days and too soon to tell what these changes might achieve.

The second change in the SSC's work has been the development of the 'capability, accountability and performance project'. The commission is working closely with other monitoring agencies: the Treasury, the Department of the Prime Minister and Cabinet, and Te Puni Kokiri (Ministry of Maori Development) to make improvements in the way that departments plan and report on their work, and in the way that agencies monitor that work. At the time of writing, the project is currently in a pilot phase, working with four departments and ministries: the Department of Conservation, the Department of Corrections, the Department of Labour and the Ministry of Women's Affairs.

The project is remodelling the accountability documents of these departments and ministries to set out longer-term objectives and the organisational capability to achieve them, as well as what work will be done in the next 12 months. This remodelling has the potential to stimulate improved planning, management and monitoring processes. As well, the documents should provide better information to parliament, the government, ministers, managers, monitors and the public. The information produced should be as relevant to the internal management processes as it is to the external monitoring functions. In the past, information has been generated to satisfy the external reporting requirements, with limited relevance to internal management requirements.¹⁶⁵

The accountability documents involve a three-year 'statement of intent' supported by an annual 'output agreement'. The Ministry of Women's Affairs' new statement of intent covers:¹⁶⁶

- the purpose, vision, mission, values, relevant government priorities and outcomes;
- environment;
- medium- to longer-term objectives;
- plan for the coming year including output objectives, ownership objectives, monitoring and reporting, risk management, key financial statistics and strategies; and
- statement of responsibility and forecast financial statements including summary of output classes.

The third change promoted by the SSC towards improving accountability arrangements of departments and ministries is the development of a co-ordinated approach to monitoring. The central agencies are sharing monitoring information, thereby improving the quality of their basis for monitoring. The joint monitoring makes the monitoring process more efficient for departments. Memoranda of understanding between the monitoring agencies and each department are being developed. This has the potential to lead to formal monitoring plans between the central agencies

¹⁶⁵ State Services Commission, *Assessment of the State of the Public Sector*, Wellington, 1998. The report cites a study by the Treasury that found that financial systems were geared to external, and not internal, requirements.

¹⁶⁶ This is a first attempt at a statement of intent and at this stage has a one-year rather than longer-term focus.

and a consequent improvement in the clarity of roles and the quality of monitoring.

A fourth change involves combining retrospective departmental performance assessment with a more forward-looking assessment of capability. The 'capability accountability and performance project' has been experimenting with the use of the European Foundation for Quality Management's Business Excellence Model as a tool for reviewing organisations comprehensively, as well as considering other monitoring approaches. Reports on capability are being provided to ministers to support them in their discussions with chief executives. In what is intended to be a twice-yearly event, the SSC meets with each minister to present the SSC's view of the performance and capability of the department or ministry in which the minister has an ownership interest. The departments and ministries are consulted about these briefings, although they represent a commission view rather than a negotiated one. This is being generally well received by ministers.

The SSC role covers government departments. Crown entity and SOE ownership monitoring are outside the SSC's role. In order to respond to the criticism of a lack of attention to the ownership interests of all government agencies, the central agencies, including CCMAU, should develop a comprehensive policy and implementation plan aimed at establishing government-wide excellence in the conduct of ownership monitoring and control. Roles should be specified and allocated among the monitoring parties, and strategic business plans developed for each of them. There must be commitment to scheduling the monitoring activities, taking into account the resource costs for the organisation being monitored. It is disruptive to line managers to be subject to multiple monitoring from different organisations, each typically seeking to expand their area of interest and each having roles that overlap with one another. Some moves are being made by the Treasury and the SSC to co-ordinate monitoring for a group of pilot agencies that are involved in a project to improve capability development.

A well-run department has a high capacity for self-monitoring and will have all the necessary information systems and internal controls to permit routine external monitoring to be done at low cost. Regrettably, there remain many public organisations where this level of internal self-management has yet to be reached. The answer is to drive management improvement from the top of the organisation through the powers of the state services commissioner. It would be a mistake to surround the middle layers of the departments with detailed external monitoring activities, particularly if they

are conducted by people in central agencies who lack the background experience to ensure a low cost and effective process.

Ownership monitoring by central agencies, when the necessary management development has been undertaken, should be focused, strategic, penetrating, fair and with periodicity suitable to the organisation itself. As discussed in chapter seven, the costs of implementing this approach need to be weighed against the benefits in improving performance.

The top management of the Treasury was concerned at the time of the early state sector reforms that the administrative functions that had controlled inputs would morph to become a monitoring industry. This appears to have happened because the state services commissioner told the select committee on government administration in 2000 that a range of reporting documents has created a compliance industry that does not necessarily provide useful information. Central agencies should develop principles and processes of dialogue with public organisations that seek continually to limit transaction costs. This is about refining the performance objectives to those that truly matter to the government and to use internal audit processes more than at present to address routine dimensions of performance and accountability.

MANAGING FOR QUALITY

The techniques of quality management are only haphazardly applied in government. This is a result of the decentralisation that left to the chief executives the choice of method and level of commitment to quality management. Some chief executives have taken to the approach with alacrity. The Inland Revenue Department has done much work in this area and at least one department, Social Welfare, has won an award for its endeavours. The Education Review Office is also involved with quality management networks.

By contrast, the distinguishing feature of the work in reform of the US federal government is its emphasis on bringing comprehensive philosophies and practices of quality management to government. When the vice president launched his initiative at the beginning of the Clinton administration, he emphasised this approach to the work. The approach differed from the thrust of reform in many other countries that had more in common with the New Zealand, Australian and British models. The US federal government expected to take between four and eight years to complete this work and hoped that they could thereby restore trust in government. This is a lot to ask of any quality management philosophy.

As things have turned out, the percentage of Americans in polls who agree “that they trust the government to do the right thing all or most of the time” is around 40 percent, having bottomed out at 20 percent in 1994. In 1964 the rating was 75 percent. Scientifically it is impossible to know what experiences give rise to these poll figures but the administration is understandably convinced that they are positively affected by the rapid spread of quality management techniques through the US federal government.

The vice president himself saw the restoration of faith in the government in starkly dramatic terms:

Faith in government is at a low point, and that lack of faith threatens the nation’s future. Government can’t do everything, and it certainly shouldn’t try. But some national problems like drugs, violence, poverty, and pollution can be solved only by Americans working together through our system of self-government. If we lose faith in that, we abandon the future to chaos. Reinvention restores our faith. Americans find government service improving over the counter and over the phone. Business leaders find Federal regulators ready to use common sense and to look for common ground. Communities find the walls coming down between agencies and levels of government, and beyond the old walls they find partners ready to do whatever it takes to solve problems. Reinvention is securing the future of self-government and America.¹⁶⁷

Poor service arising from the traditional bureaucratic culture is doubtless one of the reasons for the cynicism about government that has grown over many years, although it is far from the only reason. In the United States a growing number of federal agencies have remarkably high standards of customer service. New Zealand, too, can claim some great improvements in customer service in social welfare, labour, internal affairs, inland revenue, valuation and elsewhere. The overall impression, however, is that progress has been too dependent on the dedication of individual senior managers who had deep personal commitments to improve service.

More can be done to improve services. The time has come for the systematic application of quality management principles in every government agency. It must be stressed that there is not a universal formula for doing this. Rather, what is needed is a commitment to explore energetically how to serve better the citizens who are affected by a government service, and to not rest until the quality matches the best

¹⁶⁷ Al Gore, *The Best Secrets in Government, Fourth Report of the National Performance Review*, Random House, Washington DC, 1996, p 120.

standards that have been achieved for similar services anywhere in the world in government or the private sector. The actual methodology involved in any situation will be unique to that case. It may mean staff retraining, different recruitment strategies, advanced information technology, detailed documentation and analysis of production processes, advanced intellectual capital development, privatising some services, embedding new values and culture, and so on. It involves a restless attitude to the constant search for better ways to meet fundamental commitments to service to the government and the people.

Bob Stone and his team in the US government's Office of National Performance Review have promoted a sizeable collection of case studies that are generally well documented and easily accessible through the internet and other publications. This body of experience, together with similar materials from the United States and from other countries, could provide benchmarks for service improvements in those New Zealand government agencies where quality management has not been the key driver of organisational change in the past.

The government of Hong Kong has also demonstrated a commitment to quality improvement over many years. So has the Singaporean government. These governments are arguably the most competent in Asia today.

The SSC should take some responsibility for establishing a programme with the Management Development Centre,¹⁶⁸ with the objective of ensuring that quality management techniques are well understood and that expectations are established for all government bodies. Ministers could encourage quality gains by using the performance agreements to set expectations.

MANAGING RISKS

Risk management tends to be under-developed in many government agencies. Formal risk management was operational in less than 40 percent of departments in 1996/97 and 70 percent by 1997/98.¹⁶⁹ The SSC's standards report notes that:

... in an endeavour to seek reasonable assurance from chief executives that risk management is well integrated and fully operational within their departments the commission has produced a set of expectations on risk management. These

¹⁶⁸ The Management Development Centre is discussed further in chapter eight.

¹⁶⁹ *Draft Collation of Public Service Department Performance Assessments for the Year Ending June 1998*, State Services Commission, Wellington, 1998.

expectations, which the commission is seeking to have executives report against, are based on the Australian/New Zealand Standard on Risk Management.¹⁷⁰

There are well-developed risk management systems available to government agencies. To be effective they require the detailed attention of managers to identify specific risks and measures to control them.

BENCHMARKING AGAINST THE PRIVATE SECTOR

Ten years ago the public sector set out to close the gap between public sector management and the best private sector management. A raft of management techniques was brought into the public sector. For the most part, the adaptation of these methods to a public sector environment was done successfully and, by now, any top manager in a public agency can be expected to be familiar with and know how to implement advanced management methods from anywhere in the public or private sectors. Senior management in all agencies must keep in touch with best practices in the public sector in New Zealand and in similar organisations in other countries. They should also be up-to-date with developments in the private sector.

The New Zealand private sector does not appear particularly well managed by international standards. Several research reports have noted that some New Zealand corporates have failed to meet the cost of capital in their businesses. This is because they are focusing on objectives other than the creation of value. Executive compensation has been exceeding what would be expected given the poor performances in creating shareholder value.¹⁷¹ Only a few companies can claim to be at world best standard. Public managers need to draw their comparisons with care. By the same token the best public organisations have much to contribute to the private sector in areas where the public sector has established skills.

In the private sector in recent years there has been very rapid advancement of techniques and inter-firm relationships for the purposes of benchmarking. These studies can be very analytical and detailed and involve the deconstruction of business processes to search for innovations in cost and quality. Not much of this type of analysis occurs in the public sector. There is a large body of information in the private sector that could be adapted for use in the public sector. While the environment and culture of the public sector

¹⁷⁰ State Services Commission, *Responsibility and Accountability: Standards Expected of Public Service Chief Executives – Key Documents*, *loc cit.*

¹⁷¹ See for example, ANZ Investment Bank, *Corporate New Zealand Shareholder Value Report*, Issue No 1, October–December 1999; *The Independent*, 14 April, 1999, p 16.

are different, many of the business processes inside public organisations are similar to processes in the private sector. There is much to be gained by public organisations entering benchmarking relationships in a way that respects the key differences between the sectors, while also enabling some of the vast knowledge that has accumulated in the best managed companies to be available for adaptation to the public sector.

Benchmarking systems and techniques are now well entrenched in the better-run New Zealand companies. Government agencies could look for partners in the private sector and from the public sector in other countries to benchmark their business processes to the highest standards. Some New Zealand companies, and the local branches of international companies, have for many years been willing to assist the public sector to keep in touch with the best management practice. They will take the time of their executives to share experiences and have been known to offer their key staff to appraise the condition of management systems in departments and to give free advice. They have arranged visits to the public sector by experts who are in New Zealand on other business, and for visits of New Zealand public managers to their head offices and affiliates overseas. It could be expected in New Zealand, as in the United States, that the private sector would welcome the opportunity to work in these partnering arrangements with government agencies. There are a number of these relationships established, but the potential is only just beginning to be realised.

Managing partnerships with private sector organisations is not difficult, but it requires care in establishing the ground rules for the engagement. There are deeply embedded cultural differences between the two sectors, for example, around attitudes to the protection of information. Benchmarking processes and rules are now well established in the private sector, but generally they do not involve substantial commercial transactions and are therefore at the easy end of the spectrum of partnership arrangements. Departments that let commercial contracts would have to be careful about the relationships they established. The advanced state of these relationships in the United States should be seen against the background of a political culture that has more positive attitudes towards private enterprise than exist in New Zealand.

The senior managers of the departments and Crown entities ought to organise benchmarking initiatives. As more is learnt about the successful application of these techniques and their possibilities for service improvement, the SSC should include in the ownership monitoring of chief executives a segment on the application of advanced quality management

techniques. Benchmarking provides one basis for the evaluation of what has been achieved.

If the impetus remains low for managers to initiate benchmarking, ministers could set expectations that this occur. The work could be assisted by the SSC and the Treasury facilitating benchmarking studies.

PERFORMANCE AGREEMENTS

Performance agreements provide the tool for setting out expectations and give a basis for the assessment of performance against these expectations. Performance agreements can incorporate the necessary requirements for performance with respect to the ownership dimensions, such as specifications of financial results, human resource development, information technology systems, research and development, quality improvement initiatives and periodic goals for the enhancement of particular areas of policy and administration. Requirements for advanced practices in strategic management can be established, together with expectations about internal audit and the evaluation of results for policy expectations and outcomes. The assessment and management of risks of various kinds could also be incorporated.

As with any performance specification, these requirements should be short, simple, easily understood and capable of assessment following performance.

Leadership

Improvements to setting expectations and measuring and monitoring aspects of capability will improve the incentives on chief executives and managers to develop their staff and improve their systems and practices. Some managers are well disposed to devoting resources to this; others are short-sighted in this area and fail to make long-term investments in staff development and management systems. There can be an excessive reliance on other organisations to produce a pool of skilled personnel and too little staff development within government organisations.

Investments in staff development should increase the potential for attracting and retaining future leaders, but this alone will not be sufficient. The public service has to be an attractive place to work. Good governance, accountability and management systems and practices can enhance the working environment. Another critical aspect is the quality of government policy and ministerial leadership. If this is poor, particularly over lengthy periods, talent will fail to come and fail to stay. New Zealand is currently

facing problems of shortages in government in senior management talent in some skill areas such as legal and information technology. Chief executives carry the responsibility for developing tomorrow's leaders.

CONCLUSIONS

Performance specification in respect of the ownership interests of government needs to be upgraded. This involves developing more advanced concepts, and promoting expectations about ownership goals. It also needs backing with more sophisticated methods and changes in the approach of central agencies. There are ten years of lessons to draw from and it should not be difficult to design and implement an effective system for setting expectations, collecting information and providing feedback and incentives in ways that do not place an undue burden on line managers. The SSC and the Treasury are undertaking work in this area with four pilot agencies. This extends to co-ordinating the agencies' monitoring work, improving the accountability documents and providing ministers with better information to set expectations about capability.

There are opportunities to improve the quality of monitoring further by considering the various activities of the monitoring agencies, developing monitoring plans and undertaking monitoring in a much more co-ordinated way.

There have to be incentives for agencies to take an interest in ownership factors. Attention from ministers and high-quality monitoring would provide this incentive which has to be based on sound information. The pilot project offers one avenue to improve the information base. It needs to be supplemented with further work to implement processes that improve the assessment of the efficiency and effectiveness of government organisations. The developments within the SSC to improve its capability could result in better ownership monitoring and stronger incentives for chief executives and ministers to attend to ownership issues. The SSC's appointment of a deputy from a senior position as a management consultant in the private sector in 2000 was an encouraging move.

TOP PERSONNEL MANAGEMENT

INTRODUCTION

The New Zealand system of public management places great responsibilities on chief executives and expects high performance from them. The processes for recruiting, developing and supporting chief executives are, therefore, crucial to the performance of the government as a whole. This chapter discusses the main issues in the management of the top level of the public sector's human resources.

DEMANDING BUT FULFILLING JOBS

Chief executives of government departments are required to function in a distinctive and complex environment.

General employment law is based on a relationship in which both parties are required to obey the law in the dealings they have with each other, but the relationship between them remains essentially a private one. By contrast, public sector chief executives are employed in a public context with numerous accountabilities that are not clearly ranked and that can conflict. Their legal employer is the state services commissioner but they also have important obligations to their ministers. In addition, they are accountable to the government as a whole, to parliament, and ultimately to the public. A chief executive's public accountability is particularly strong when the agency they manage holds coercive powers such as the powers to arrest and detain citizens, or when the chief executive manages a department that is the sole provider of essential services.

Departments spend public money in accordance with rules set by the authority of parliament. They must act according to laws that extend well beyond simply complying with specific provisions that are set out in acts or regulations. These include the provision that a person who has been given any kind of statutory authority must exercise that authority properly and reasonably in both substantive and procedural terms. Their decisions are subject to review under public law.

Senior public servants are responsible for implementing the policies of governments past and present. Effective performance provides credibility and continuity to policies. Equally, performance failures undermine public confidence in policies that may otherwise be highly regarded.

It is to be expected that politicians and the public will want to be satisfied that departments are being managed wisely and well. Indeed, many features of the political and constitutional arrangements that New Zealand inherited from Britain, which have been refined and developed in this country, are rooted in a desire to exercise effective control over governments and their agencies, to curb their excesses, and to be able to hold them to account. Today, government agencies are also expected to be innovative, which adds to the fundamental tensions between the different and sometimes conflicting demands on them. In seeking to operate properly and effectively in this distinctive environment, chief executives must balance many forces.

As examples of these tensions, the chief executive who is required to develop, promote and evaluate policy proposals in a way that reflects their best professional judgement, must also be willing to accept whatever decisions ministers make and to implement them with dedication and commitment. The chief executive who is required to support and advise the current minister and the government of the day must also remain non-partisan in a party political sense and retain the ability, and credibility, to do the same for ministers in any future government. The chief executive who is required to accept public responsibility for their own performance and that of the department is also required to respect and defer to ministers and their role in the processes of government, even though the performance of the ministers may be inadequate.

Chief executives must manage and develop their organisations so that they can meet the current and future demands placed upon them. To do this they must:

- be prepared to present proposals for the strategic direction of their departments and assist ministers to translate government strategies into practical action plans;
- build management systems that delegate the authority necessary to enable staff to work effectively, while preserving the line of accountability back through themselves and on to the minister and parliament for delivering on the agreed performance;
- report in detail on what has been achieved in ways that meet the differing requirements of the Treasury, the SSC, ministers and parliament;
- ensure that the department meets all relevant statutory obligations and meets the behavioural expectations of the government, the parliament and the public;

- be trusted and effective advisers to their minister, while retaining the ability to maintain an arm's-length, dispassionate relationship with the minister and others; and
- balance their obligations to their ministers with their broader responsibilities to the law, to parliament, to the government generally, and to their own moral and professional code.

All of this takes place in a public and political 'fish bowl', in which the actions of chief executives and their departments can be called into question in a variety of ways: through the courts, in the media, before parliamentary select committees, by the ombudsman, and through the operation of the Official Information Act 1982.

The days of grey, anonymous public servants who advised their ministers and whose ministers spoke for them on any matters of substance are long gone.

Chief executives of New Zealand government departments have been given unparalleled managerial autonomy by international standards, and are expected to deliver substantial gains in efficiency and effectiveness in return. Their records are open to detailed public scrutiny and examination by select committees. They cannot always rely on the unqualified support of their ministers. At times their own ministers have left them swinging in the wind or even used them as a shield.

Managers in the private sector who would be considered competent and well-qualified may not be suited to this atypical managerial environment. For the right people, however, the unique challenges, opportunities and satisfactions can be immensely rewarding. Many senior public servants are gifted individuals with a personal passion for the work they do. They enjoy the opportunity to express their creative energies through the ability to serve the public and the nation. Many would not wish to work in the private sector because of a personal orientation to the public service and an enjoyment of the complexity and importance of the work they do. The systems used in managing human resources need to tap into these motivations.

In the following pages the main elements of the employment framework are discussed.

CHIEF EXECUTIVES IN THE 1990S

As part of their description and assessment of public management in New Zealand, Boston *et al* carried out an analysis of chief executive appointments

since the State Sector Act was introduced in April 1988 until the time of their study in 1996.¹⁷² An interesting picture emerges.

From 1988 to 1996, about 60 chief executive appointments were made, in many cases following the restructuring of existing departments and the establishment of new ones. About 20 chief executives were re-appointed to the same positions and a further five chief executives have had their contract extended by less than five years.

Of the 33 chief executives in post when the State Sector Act 1988 came into operation, only three remained by 1996, none of them in the departments where they were employed in 1988. At least seven departments had two changes of chief executive in those eight years and one department, Defence, had three.

According to the study, the chief executives appointed in that period:

- were more highly educated and had more varied work experience than was the case before;
- had, in three cases, been recruited from overseas, two from Australia and one from Canada;
- included more women, eight in mid 1995, down to six in 1998, compared with only two in 1988;
- still did not include many Maori or Pacific Island peoples – there was one of each heading special Maori and Pacific Island agencies; and
- were on average slightly younger than before and included a number of people appointed in their early forties or even younger.

About 25 percent of the chief executives were appointed from outside the core public service, but more than half of these appointments had some previous experience working in a government department either in New Zealand or overseas. Very few outsiders were appointed to policy departments.

Most chief executives appointed were placed on five-year contracts, although an increasing number in later years were employed on shorter-term contracts. There were a variety of reasons for this including the preference of the appointee, pending structural changes to the department, or the appointment of someone to carry out a specific, time-bound task.

The State Services Act 1988 introduced a contractual term of five years for chief executives. The SSC has the habit of offering an additional three years

¹⁷² Boston *et al*, *loc cit*.

to executives who perform well, at the end of their first five years. This results in practice in a maximum of eight years in one position.

Some chief executives resigned before their contracts expired. Some of these resignations were influenced by a difficult working relationship with the minister concerned. One chief executive was not re-appointed after the initial contract period, and one declined an offer of re-appointment.

The results, in terms of the objectives of the Hon Stan Rodger, the minister of state services in 1988, show some gain but not as much change as was hoped for. The skill levels of executives have risen and there is more diversity, although the numbers of women and Maori are low. The management team is younger. The turnover of chief executives appears quite high but may not be higher than under the previous system, under which middle-aged men waited in line for their turn at the top jobs and then went into retirement.

Top jobs for policy ministries still go to insiders, which is not surprising given the uniqueness of these positions to the public sector. It is noteworthy, however, that the appointment as secretary to the Treasury in 1997 was a person who had not previously worked in a government department, although he had been the head of a regulatory commission.

THE COMPETENCIES THAT CHIEF EXECUTIVES REQUIRE

While the skills required of a public service chief executive are common to senior management positions in both the public and private sectors, some skills are specific to the public service.

The Logan review group identified management development as the critical senior management issue and urged the adoption of an effective service-wide framework to meet this need. A steering group of public service chief executives was convened to develop detailed proposals for such a framework. It concluded that management development should take place in the context of a competency-based approach.

In 1992 a study was conducted on the competencies seen as desirable in chief executives. It consulted a selection of chief executives, with input from ministers, opposition politicians, academics and senior managers in the public and private sectors. Further work on the subject led to a model based on nine core competencies that was developed with the assistance of private sector consultants and is summarised in the Appendix to this chapter.

Because they are core competencies, it was always recognised by the SSC that they do not describe the full range of competencies that any individual

chief executive will need to exercise in a particular role or position. Specific jobs have specialist competencies critical to good job performance. It was also recognised that the competencies needed to be seen in the wider context of the values, ethics and the core professionalism of a politically impartial and non-corrupt public service.

This method of describing and assessing the requirements of individuals for top jobs is a powerful tool for improving the management of the top executive team. It is far superior to the traditional methods of relying on seniority and qualifications. It supports a more open appointment system that looks for people who have the best fit to the requirements of the job, and resists some previous biases in appointment processes. The method can help in identifying and developing management potential, and can contribute to other aspects of personnel management by clarifying how successful managers actually behave in their positions. As indicators of effective behaviours, core competencies contribute to the government's ownership interests by encouraging clarity in the specification and monitoring of performance requirements.

The current competency model must be backed by research, be refined and kept fresh. This is primarily the responsibility of the SSC, but it should be developed collaboratively with the chief executives, to ensure harmony between the approaches used within departments and across departments for top executives.

THE APPOINTMENT SYSTEM

A summary of how the appointment system works currently is set out in the Appendix to this chapter.

A key feature of the system is the power of cabinet to reject the recommendation from the panel convened by the state services commissioner. Cabinet can appoint an alternative candidate or require the appointment process to be carried out again.

The first of these two possibilities was explicitly envisaged when the new system was introduced. It is not the only way in which ministers can influence the appointment process. There is also scope for them to do this by the advice they give to the state services commissioner on the nature of the job and the portfolio of skills and experience required. The possibility of cabinet overruling SSC advice and appointing an alternative candidate attracted the most criticism and attention when it was introduced, on the grounds that it paved the way for appointments to be made on overtly political grounds.

In practice, however, cabinet has not appointed against SSC recommendations. This is scarcely surprising, because ministers have strong incentives to ensure that their departmental heads have high credibility with staff, select committees and stakeholders in the department's activities. After the strong bias against outside appointees was removed, a person with such credibility would have a fair chance of being appointed anyway.

For his part, the Hon Stan Rodger saw the new system as an elegant compromise between allowing the possibility of greater and more explicit political input into the process of appointing chief executives and preserving the apolitical and professional character of the public service. He was determined, however, that the power that ministers now had to reject the state services commissioner's recommendation should not be used so long as he remained minister of state services, and it was not.

The 1962 McCarthy Royal Commission into the state services was actually the first to recommend this appointment arrangement, but its suggestion was rejected. The commission argued that the state services commissioner could and should assess all aspects of potential heads of departments, except the extent to which the potential appointee had the confidence of the government. That was seen as an essential quality of the appointee that only ministers could judge, and recognised that ministers should be prepared to make this judgement in a publicly accountable way.

The second of the two appointment options now available to ministers, if they do not wish to accept the recommendation from the state services commissioner, is to require that the appointment process be carried out again. This option emerged unexpectedly, following the first instance of the government actually rejecting an SSC recommendation. This occurred in 1990, when the then Labour government (after Hon Stan Rodger had been replaced as minister of state services) rejected a recommendation to appoint Gerald Hensley as secretary of defence and directed the SSC to put forward another recommendation. The SSC then approached a number of potential candidates who had not originally applied for the position, including senior Treasury official John Chetwin (later secretary of labour) and recommended him for appointment. At this stage, however, the solicitor-general gave legal advice that the vacant position would have to be re-advertised publicly before an appointment could be made. This advice was accepted and, in consequence, it was made known publicly that a recommendation to appoint Gerald Hensley had been rejected and that the position would be re-advertised. John Chetwin then withdrew himself from further consideration.

Following a further round of public advertisements the management consultant advising the SSC suggested a person from outside the public service, Harold Titter. He was approached, interviewed, and appointed to the position for 12 months. After the election in 1990 the National government accepted a further recommendation to appoint Gerald Hensley.

Thus, it was clearly established that ministers had the option of rejecting a recommended appointee and requiring instead that the appointment process be started again. There have, fortunately, been no more examples of this. The state services commissioner is not the secretariat for a process run by cabinet but is the symbol and the reality of the non-political appointment process.

Defining the proper role of politicians in the appointment process of chief executives is a delicate balance. Ten years ago the rationale for allowing ministers to reject an appointment and substitute their own was simply that ministers, not civil servants, are directly accountable to the people through their political mandate and should, therefore, in unusual circumstances be able to override the SSC's advice. Although there was an undercurrent of concern that this could allow for politicisation of appointments, in fact ministers had always been able to reject or influence appointments in a limited way under the previous system. Formerly, the SSC consulted ministers about the acceptability of proposed appointments, but in a less transparent way than is now required under the State Sector Act 1988.

In one instance in the early 1980s, senior officials were concerned that a minister, now long since retired, might in effect be actually making an appointment, by rejecting the SSC's preferred candidates one after the other until the one he wanted emerged. The prime minister intervened and an SSC recommendation was accepted.

Experience since 1984, and a more sophisticated understanding of the incentives on politicians, suggest that the degree of political influence on appointments is usually not excessive but there have been instances where it might be seen as such. Generally, experienced ministers see that their own needs for impartial advice and effective administration are best served by working with seasoned professional civil servants. It would be very valuable for the SSC to conduct some formal research into the patterns and lessons from long experience.

The overriding objective of the appointment process should be to assemble a team of highly experienced and talented advisers who are committed to an ethic of public service and responsive to changing government agendas. This has never been easy. The effect of any greater degree of politicisation of appointments and perhaps of other aspects of the

system would cause civil servants to perceive the career ladder as stopping below the top. This would also signal that late in one's career, when mobility is restricted, one might be working for a politicised chief executive. These effects would corrode the overriding objective of a disinterested and responsive public service.

On the other hand, if the political influence is too far removed, there is a danger that governments may feel concerned about a lack of commitment to implementing government mandates. Rt Hon David Lange expressed publicly just such a concern in the run-up to the election in 1984. In the run-up to the 1999 election, the shadow treasurer, the Hon Michael Cullen, was reported to have named the heads of the ministries of Education, Commerce, Department of Prime Minister and Cabinet and the state service commissioner as people he wanted to see sacked.¹⁷³ The opposition parties also made it clear that they would be looking closely at the situation regarding the chief executive of the Department of Work and Income New Zealand. In the months immediately after the election the minister of social welfare declared himself satisfied with the latter chief executive, although he subsequently pulled back from that position a little. The prime minister let it be known that she was content with the head of the Department of the Prime Minister and Cabinet after some public statements of concern about his policy views.¹⁷⁴

The minister of state services, Hon Trevor Mallard, said in a speech:

... I know public servants are working really hard to implement the government's policies ... By and large, they've [the public service] realised that there is now a government with quite different priorities and policy objectives.¹⁷⁵

The means to the balance of responsiveness to government agendas on the one hand and apolitical professionalism on the other lies in the strategic planning process, the output-based performance agreements, the role of the SSC and ultimately the professional and managerial culture of public organisations.

The strategic business plan that is discussed in chapters seven and 11 should provide transparent evidence for what will be done and how it will be done within a department, while allowing managers the freedom to act within this framework with authority and autonomy.

¹⁷³ Reported in the *National Business Review*, 15 October, 1999, p 15.

¹⁷⁴ Reported in the *Sunday Star-Times*, 16 January, 2000, p C2.

¹⁷⁵ Hon Trevor Mallard, "Complying with the new government's priorities and plans for improving public sector performance and accountability", speech 3 May, 2000.

The state services commissioner is a political appointee in the sense that the commissioner is appointed by the prime minister. On one occasion when I was involved in the appointment of a state services commissioner, a panel advised the minister of state services who made a recommendation to the prime minister. Sometimes the appointment process is less structured. The state services commissioner has responsibility for the integrity of the civil service. This assigns and personalises the responsibility for managing the tension between the ministers and the professional public servants. The state services commissioner must protect the fundamental principles and values of the public service. At its best, the SSC is forthright in defending the appointment process of chief executives and other processes from immediate political pressures, while being accountable to the government for ensuring that its chief executives and their departments give effect to government policies and priorities. The SSC's incentives are to ensure that the public service is responsive to the government's programme, while defending chief executives from political pressure and interference that could undermine public confidence and lower capability and morale in the public service. There have been times over the years when I think the SSC could have been more forthright in defending public servants from political attacks.

Comments from reviewers

The Logan review group, Boston *et al*, and Schick have all commented on aspects of the recruitment and appointment system.

The Logan group endorsed the basic elements of the appointment system as it had evolved, including the power of the government ultimately to appoint a person of its own choosing. The group argued that such a power was necessary, if only to resolve the potential impasse that could otherwise occur if the government was not prepared to accept the state services commissioner's recommendation and the state services commissioner was unable or unwilling to recommend anyone else.

As far as the operation of the system in practice was concerned, the Logan group found that:

Qualified private sector executives are reluctant to take on public service chief executive positions because of the perceived high level of political intervention, public scrutiny, the bureaucratic nature of the work and the inadequate remuneration packages. A lack of public service experience is also seen as a handicap.¹⁷⁶

¹⁷⁶ Logan, *op cit*, p 79.

The group also suggested that there were three aspects of the appointment process where the state services commissioner should make improvements:

- the length of time taken for some appointments;
- the composition of the panels convened to advise on particular appointments; and
- the need to take account of the unique aspects of particular departments when job documentation was being prepared.

The time taken to make appointments had sometimes led to people acting in chief executive positions for long periods. In ten cases the period lasted for more than four months, effectively putting the department into 'maintenance' mode and reducing the likelihood of innovation and the development of strategic initiatives.

Boston *et al*¹⁷⁷ criticised the so-called 'third way', under which ministers could reject a recommendation and require the state services commissioner to carry out the appointment process again. In particular, the authors criticised the way in which the third way provided for political input into the process without allowing for an efficient and satisfactory way of resolving situations such as another intervention like the Hensley case. On the other hand, Boston *et al* acknowledged that ministers might choose to reject a recommended appointee but wish to avoid politicising the process further by directing the appointment of a named candidate of their own choosing.

The Boston group recommended, therefore, that the state services commissioner be required to submit two potential appointees and specify a preferred candidate. The government would then be required to accept one of the two recommended appointees or publicly direct the appointment of some other specified person. There would be no 'third way'.

Whatever intrinsic merit this proposal may have for dealing with the political input, there are practical difficulties. This short-listing would have the effect of placing the individuals in a two-step recruitment process, with an incentive to make themselves appealing to politicians at the second stage. Such a process would weaken confidentiality for candidates. The SSC sometimes has difficulty finding one candidate in whom it is fully confident so that finding more than one could be a problem. The government might still object to all those on the short list.

I prefer the current approach. The state services commissioner should propose appointees. The state services commissioner holds a statutory office

¹⁷⁷ Boston *et al*, *loc cit*.

and cannot be removed by a government without parliament being consulted. This counter-balances any pressure from particular ministers with preferences for candidates that are not based on the professional and managerial skills of those candidates.

Schick saw the appointment process as complex (it involves more than 40 steps), rigid and costly. He urged the state services commissioner to explore ways of making the process more flexible and quicker, but supported the continuing involvement of the state services commissioner as the guardian and promoter of the public interest. I agree.

Amongst other things, a speedy and less uncertain appointment process may help to encourage suitably skilled private sector candidates to put themselves forward for consideration. The long delays arise because the appointment committees are not satisfied that they have a candidate in whom they have complete confidence and so the search process is renewed. If the SSC is more successful in building a cadre of executives who are ready for promotion by taking a stronger line with chief executives on their obligations for succession planning, the delays will reduce.

REMUNERATION ISSUES

The remuneration of top government officials must strike a difficult balance between the need to recruit the necessary talent on the one hand and the disapproval of large salaries expressed by the media, sections of voters and numerous politicians on the other. We get this balance wrong more often than we get it right.

The salaries for heads of departments from December 1986, as determined by the Higher Salaries Commission, are set out at the end of this chapter. This shows the situation just before the state sector reforms.

Some features of the previous remuneration system are strikingly apparent from this table:

- the allocation of departments into five salary groups;
- the single salary figure for chief executives in each group, which shows the lack of any provision for bonus or performance payments; and
- the small margin (38.6 percent) between the lowest ranked group of departments and the highest, only one of which (the Treasury) was actually a government department proper.

An early visible consequence of the State Sector Act 1988 was a substantial increase in the remuneration of chief executives and the introduction of novel remuneration elements, such as cars for private use and the provision

for performance bonuses. This followed the introduction of a remuneration system based on job evaluation, assessment of individual performance and linkage to private sector pay rates for positions of comparable size and responsibility.

The margins were also increased. Under current arrangements, the base salary for the highest ranked chief executives, in terms of job size, is more than double that of the lowest ranked chief executives.

The equivalent information for 2000 appears at the end of this chapter. The margin between the lowest salary and the highest was 150 percent in 2000 and 116 percent in 1999.

Before the State Sector Act 1988, the salaries for permanent heads were set in salary bands for groups of positions. The salary levels were influenced partly by the number of staff employed in the department concerned, which created an incentive to sustain and grow staff numbers. The Higher Salaries Commission, which set the salaries, always balanced off requirements for recruitment and retention against the benefit of security of tenure, the implications of public sector wage movements for private sector wages, and a collection of other norms and principles. The result was a compressed wage scale with salaries for star performers far below market values. The current system is far less constrained by the previous norms, although they remain in the background as a major pressure to keep salaries within politically acceptable limits. In 1999, the Labour and Alliance parties expressed concern that top salaries were too high and announced their intention to review the top salaries in the public sector if they formed the next government. Once in government they appear to be constraining top salaries while taking a softer attitude towards the unionised workforce.

When Hon Stan Rodger introduced the State Sector Bill in parliament, he confirmed that salary levels were important:

It must ... be recognised that if the public service is to compete for top-quality managers it should be able to offer competitive rewards.

There was always the risk that successive governments would take a conservative approach to the remuneration policy for chief executives and that public sector pay rates would again fall behind those of the private sector. In practice this is exactly what happened. On several occasions the government, acting for political reasons, has asked chief executives to forgo recommended pay increases and they have agreed to do so. In consequence, the competitiveness of public service remuneration for senior staff has fallen behind the private sector. The ability of the state services commissioner to reward outstanding performance through additional remuneration has also

been significantly constrained. The issue, and the problems associated with it, are not new. As long ago as 1912, the Hunt Royal Commission reported that:

We are strongly of the opinion that the salaries paid to the heads of departments and those holding highly responsible positions throughout the Service are not adequate.¹⁷⁸

From time to time state services commissioners have argued that pay increases were required if the public service was to succeed in attracting properly talented people to key positions.

If the problem is not new, however, it is no less serious for that. As early as 1991, the Logan group identified inadequate remuneration as one of the factors hampering the recruitment of chief executives.¹⁷⁹

Both Hon Stan Rodger and Rt Hon Sir Geoffrey Palmer have since voiced similar concerns:

There have been serious consequences flowing from the government decision to restrain the levels of remuneration at the higher levels of the New Zealand public service in recent years. The changes were made with the deliberate intention of paying real money to meritorious people. As a result of deliberate government policy the levels of remuneration have now fallen behind that of comparable positions in the private sector and that is not a good thing ... I believe an important ingredient of the reforms was to offer genuinely competitive remuneration.¹⁸⁰

The state services commissioner has openly voiced concern about this issue in annual reports to parliament and in evidence to parliamentary select committees. In 1997 the minister of state services, Jenny Shipley, acknowledged that low pay for chief executives was hindering the appointment of suitable candidates.

Citing her experience, particularly with trying to fill the position of director-general of health, she said:

To be frank, it is not the [recruitment] process itself that limits the range of people available, it is the money available ... and

I do not spend public money easily if there is no good case for it, but the experience of [trying to appoint] the director-general of health was a graphic one.¹⁸¹

¹⁷⁸ Hunt, *Report of the Commission to Inquire and Report Upon the Unclassified Departments of the Public Service of New Zealand*, Appendices to the Journals of the House of Representatives, H 34, *loc cit*.

¹⁷⁹ Logan, *op cit*, p 79.

¹⁸⁰ G Palmer, *loc cit*, 1994.

¹⁸¹ *National Business Review*, 24 January, 1997, p 31.

Based on a straight job evaluation comparison with comparable private sector remuneration practice, salaries for public service chief executives are lagging well behind the private sector. Public service salaries could now be as much as 30–50 percent lower than private sector comparators.

Typically when remuneration surveys are carried out and people are asked about whether they are getting a fair rate for the job, they use three separate comparators:

- 1 – Am I being paid fairly as compared with what I could get outside?
- 2 – Am I being paid fairly considering the amount of effort I put in?
- 3 – Am I being paid fairly relative to my peers in this organisation?

Within these relative comparisons money matters to people.

The experiences of the past decade illustrate the importance of the SSC, or Crown entity boards, having a large measure of freedom to negotiate the remuneration packages. This is necessary to recruit people of the quality needed to take the more demanding managerial positions and to allow for the special requirements of a position at a particular time. It would be a serious detriment to the quality of the top management team over time if this freedom were reduced. The tightening of constraints on public sector salaries after 1990 has paralleled the problems of recruitment and is almost certainly a contributing factor. This is not to argue, however, that all top salaries are too low to recruit and retain people with the necessary qualifications.

Logan's comment points to negative aspects specific to the positions of chief executives in the public sector. Those setting policy for remuneration ought to recognise these points and take them into account. There are also positive non-monetary motivators for dedicated public servants, such as job satisfaction, the opportunity to help shape important areas of public policy, a sense of professionalism, and recognition and reputational enhancements. These, too, are motivating factors for many private sector top executives. They may also influence the decisions of younger recruits attracted to the public service. Squeezing the salaries of senior personnel too tightly, including those who have limited alternatives for employment, will seriously damage recruitment to the public sector in the longer term.

The remuneration paid to chief executives also sets the framework within which the salaries for other staff are determined. Setting an unrealistically low remuneration ceiling for senior managers will affect the ability of the department to pay competitive salaries to other staff. This in turn discourages departments from trying to attract and retain highly competent people because managers know that they cannot compete effectively in the labour market. Low levels of remuneration for chief executives may discourage

public service staff with the potential to become future chief executives from working purposefully towards that goal, and could discourage good private sector managers from even considering the possibility. Inadequate remuneration may cause a cycle of decline in the public service if poor management increases as parity is lost further with the private sector.

The SSC must be free to negotiate salaries at levels that enable the Commission to recruit people who have the competence for high performance in the top jobs. The Commission is constrained below this ideal at present.

In 1997 the government approved a remuneration policy that benchmarked remuneration of chief executives of departments and ministries to the wider public sector including Crown entities and SOEs. This was done out of a belief that the wider public sector was a more likely source for appointments to the core public sector than was the private sector. The state services commissioner commented that, more importantly, this indexing to the wider public service satisfied “the need to move away from the upward pressure on corporate remuneration in the private sector”.¹⁸² This appears to be a short-sighted move. It will restrict the pool of potential applicants. Chief executive salaries need to be weighed up against the considerable benefits to the country of having top performers and the substantial and long-term costs of having poor or mediocre performers.

The state services commissioner noted in the SSC’s 2000 annual report that, even when remuneration was benchmarked to the wider public sector, in the past three years of implementing the remuneration policy chief executives in the mid-range and high-end positions in the core public sector still have salaries below the benchmark for the wider public service. The state services commissioner expressed the view that he was “not ever likely to meet the market” for remuneration of the higher positions. He noted a widening gap in remuneration levels in the mid-range positions and an intention to ensure it did not result in an outflow of talent. In his conclusion he stated: “I do not have large numbers of well-qualified people able and willing to take on the responsibility of being a chief executive”.¹⁸³

The 1999 Labour/Alliance government will probably tighten constraints on chief executive salaries. Hon Trevor Mallard, the minister of state services, described the 9.5 percent increase in chief executive salaries as not being justified and as constituting a terrible signal. The minister said that the Labour/Alliance government had kept the total funding for chief executive

¹⁸² State Services Commission, *Annual Report for the Year Ended 30 June 2000*, p 8.

¹⁸³ State Services Commission, *op cit*, p 12.

salaries at the same level as the previous year. The state services commissioner had room to move by making new appointments at lower salary levels.¹⁸⁴

A key reason for the deterioration in the competitiveness of top salaries is the explicit statutory involvement of politicians in the remuneration setting process. Section 38 of the State Sector Act 1988 requires the prime minister and the minister of state services to agree to the conditions of employment for all newly appointed chief executives. Collectively, ministers have been reluctant to endorse levels of remuneration perceived by the public as high. This reluctance has also been influenced by political and economic cycles.

A more stable and predictable remuneration system might follow if politicians were more detached from the details of determining remuneration, while retaining effective political input into the performance assessment process to which it must be linked. The state services commissioner could be responsible for remuneration policy and practice. Effective controls and accountability would still exist, through the requirements for public disclosure and the continuing role of the Higher Salaries Commission in fixing the remuneration of statutory office holders such as the state services commissioner and the auditor-general. The cabinet will not stand back from the setting of remuneration if the results lead to public controversy. But the public cannot generally expect to have outstanding people in these top public service positions if ministers are unrealistic about the salary levels necessary to attract them. There is a need to justify to the public the genuine reason for paying chief executives salaries which will ensure that the public service recruits, retains and develops highly competent people. It is in the citizens' own interests that the public service delivers to a high standard of excellence and innovation. Top leadership skills are necessary for doing this.

The SSC is, and should remain, free to negotiate directly with chosen appointees but it needs a framework of remuneration policy within which to do this. The detailed methods for setting job sizes used in the private sector are, in general, a poor fit when applied to the public sector. What is needed is a model that is specifically designed to reflect the job content and responsibilities of public sector chief executives. This could then be linked, where comparisons are valid, to private sector models or methodologies used in the wider public sector, if there are any, in order to set appropriate benchmarks in a more robust way than at present.

¹⁸⁴ *The Dominion*, 6 October, 2000, p 1.

Such a model ought to take into account the need to pay realistic levels of remuneration based on the specific nature and demands of particular positions and the alternative employment options available to the people qualified to do those jobs. In other words, the market for people suited to head a particular public service department at a particular time in its history may be different from the market for people suited to heading it at another time. The remuneration paid to individual chief executives can, and should, reflect such differences.

Singapore provides an interesting benchmark for remuneration policies. It is more forthright than other countries in this region about the need for competitive salaries. Its civil service is based on competitive and merit-based appointment and compensation that is competitive with the private sector. Singapore was concerned that the ranks of civil servants in the 30 and 40 year age group were depleted and took steps to address this. Constitutional amendments were made to devolve personnel management powers and reduce the involvement of politicians. A benchmark salary was set for the grade that good professional civil servants could expect to be promoted to by the age of 32. This is pegged to 100 percent of the average salaries from tax data for the fifteenth highest paid individuals aged between 30 and 34 in six professions. These are bankers, accountants, engineers, lawyers, local manufacturing companies and multinational corporations. A second benchmark is set for the entry level for ministers. As noted in chapter five, this is two-thirds of the average income earned by the top four individuals from the same six professions. From these two benchmarks the intervening salaries are interpolated.

Comparison between Singaporean and New Zealand policy in terms of the private sector benchmarks would be interesting. Some account would need to be taken of the fact that Singapore is less democratic and more corporatist than New Zealand and has the Asian tradition of respect for civil servants that New Zealand lacks. That aside, Singapore has decided that a highly competent government is absolutely essential to its current success and its future and that private sector salaries are part of the plan for ensuring one. Many observers regard Singapore as having the best civil service in the East Asian region, with the possible exception of Hong Kong. In many respects Singapore has done extraordinarily well over many years. Its standard of living is now higher than New Zealand's. Lee Kuan Yew told Ruth Richardson and me in a meeting in 1992 that he believed that New Zealand had squandered its opportunities in the past with bad policies. As I argue elsewhere in this book, the quality of the civil service affects over time the quality of government policy.

New Zealand has a good civil service but it could be a lot better. Reasonably competitive salaries are essential to achieving this. The concern of the newly elected government about what they perceive as some high salaries in the public sector will endanger the capability of government if public sector salaries slip further behind market rates for the people it needs.

PERFORMANCE MANAGEMENT

The emphasis on the specification of performance goals for chief executives is a feature that distinguishes New Zealand's public sector management system from many other systems around the world. If this is done well, then *ex post* assessment of performance is effective not only as part of a good personnel management system but also as a basis for organisational learning. Steady improvements in the quality of the specification of performance expectations facilitate the assessment of performance. A well-conducted assessment will have an immediate influence on subsequent performance specifications. The power of this process could easily be observed at work in the early years of the public sector reforms. Output specifications and ownership objectives were established, then followed by more sophisticated practices in setting key performance objectives for chief executives above and beyond the simple specifications of outputs. The system of performance assessment has undergone a number of permutations since it was instituted in 1989.

Performance assessment

Performance monitoring and reporting is now seen as a continuous process. Each chief executive uses internal management systems to monitor and evaluate organisational and individual performance, ensuring that outputs contracted by the department are actually produced. Some of this information is also reported to ministers, central agencies and parliament.

The state services commissioner, with the support of a specialist chief executives branch within the SSC and other commission staff, undertakes performance reviews. This involves an assessment of the reported performance of the chief executive and the department in terms of the performance agreement's specified requirements, and any other relevant information. At the end of this, the state services commissioner forms a view about the overall performance of the chief executive.

The relevant minister of the chief executive and department constitutes a major source of evaluation. Information is also obtained from the other portfolio ministers serviced by the department. The prime minister and the

minister of state services offer evaluation from the wider perspective of the overall government. Information is also obtained from the Treasury regarding the chief executive's financial management. Statements of performance may be obtained from external referees, from other chief executives' peer review, and from the chief executive's own self-assessment.

The main responsibility for providing the evidence on which to base assessments about actual levels of performance lies with the chief executive, because it is the chief executive who has the best possible information about what the department is doing and the environment in which it is working. It is also the chief executive's responsibility to develop appropriate and efficient organisational monitoring and review processes for both internal management and external reporting purposes.

The SSC tries to distinguish between:

- things that the chief executive has direct involvement in and can be held personally responsible for achieving; and
- things that a chief executive is held accountable for but that would normally be delegated to others.

Both points are considered but, in the case of the latter, the existence of appropriate mechanisms to ensure that delegated authority is being used properly to deliver required results is usually sufficient for the purpose of the chief executive's accountability. However, the chief executive remains accountable for the total performance of an organisation. The subtleties of this were apparent in the Cave Creek situation, discussed in chapter six.

The state services commissioner has indicated areas of focus for performance assessments, such as the achievements in contributing to key government goals, matters affecting the collective interest, human resource management and systems of management control. These matters are contained in a standard letter to chief executives setting out performance expectations for the year ahead.¹⁸⁵ In the assessment of individual performance, referees are consulted about the chief executive's leadership, commitment to the collective interest, communications and personal development activities.

The problem for all performance assessment systems is that of asymmetric information. The individual being assessed has access to a far larger body of information than the person doing the assessing. This is a particular problem in policy and administrative functions, where simple measures of performance such as the returns on investment are unavailable.

¹⁸⁵ For explanation see Schick, 1996, *op cit*, p 36.

This problem is not unique to the public sector. In the private sector various ways of dealing with it have been tried, including transparency of information, benchmarking, internal markets, contracting out and other mechanisms.

Performance assessment of cost centres in the private sector takes place inside organisations that are subject to external market competition and conventional corporate governance arrangements. This makes it easier, at least in theory, to promote an internal culture of efficiency, and is conducive to greater pressures for efficiency than in central government departments. Pressures for good performance are created in the public sector by the desire to achieve significant goals, the contest for resources within the budget and competition for influence. There is also the quest for reputation among government departments and their chief executives, and the ultimate accountability of politicians for the effectiveness and efficiency of departments. The main challenges lie in designing institutions and influences that channel and focus these pressures so as to promote high performance, while avoiding any distortions that could cause the reverse.

The problem of asymmetric information exists because there are many government departments whose work is remote from the SSC. The chief executive being assessed has far more information than the SSC. Inevitably any point of criticism raised in an assessment interview can be contested by assertions of extenuating circumstances or other factors that are difficult for the SSC to evaluate. Various approaches have been adopted to deal with this problem, including an emphasis on gathering information, incentives to divulge information, and focusing on particular performance problems.

In the early stages of the reform process, a deputy state services commissioner, Rob Laking, strove hard to accumulate information that could be used for performance assessment. In addition, there was an emerging emphasis on self-assessment, because it helped to shift the burden of proof in a way that addressed the information asymmetry. Chief executives are expected to do a thorough assessment of their own performance that would then be the basis of questioning by the SSC and could be discounted if it did not stand up to scrutiny. In some cases, reverse assessments of chief executives by their own senior staff, internal climate surveys and other sources of information have been included in the self-assessment material.

Although this system required considerable effort by the SSC, in my view it was a valuable effort. While the need for economy in the assessment system is fundamental, I contend that it was a false economy by the incoming government in 1990 to reduce the number of state services deputy commissioners and to put a stop to this work.

The current system

After 1990, the system was simplified to move away from detailed annual assessments of all chief executives. Instead, it focused resources on areas where performance was suspect, and on deeper reviews towards the end of the five-year cycle of a chief executive's contract, with a view to providing early signals about whether the contract was likely to be renewed.

Useful additions were made to the system by strengthening the peer review from people nominated by both the minister and chief executive who had been close to some aspect of the individual's performance. The current state services commissioner is putting more weight on self-assessment and is strengthening the use of referees for judgements on performance. At the time of writing the method is being revised further to be more forward looking.

Consultation with the minister concerned and with central agency ministers continues to be a substantial influence on the final judgement about any individual's performance, but in addition, the chief executive's commitments to the collective interest of the government are now a formal part of the assessment.

One area where work is required is in the more systematic monitoring of delivery against purchase agreements. Unless there is a special unit in a ministry that monitors another department's delivery, there is no systematic checking of this. Another gap is the lack of a systematic approach to monitoring efficiency. This could be achieved through the promotion of benchmarking studies in areas where efficiency is a problem or has a large impact on results. The commission could facilitate studies, along with the Treasury, and both these agencies could assist ministers to set expectations. A third area of weakness in the assessment system is the general lack of useful information on effectiveness. The commission could be more active in assisting ministers to set expectations for the level of evaluation to be undertaken.

Finally, there is the question of how often, and with what degree of rigour, the performance of chief executives should be formally reviewed, bearing in mind that formal performance evaluation is a time-consuming, resource-intensive process that has to take its place alongside many other formal departmental reporting processes.

The annual specification of performance prior to the beginning of the financial year is a vital part of the public service management and accountability system and it must be retained. It does not necessarily follow from this that all aspects of the possible subsequent performance assessment process should be applied every year. This would be especially appropriate if a system were introduced under which the performance of chief executives

is subject to less formal but more frequent monitoring from members of an expanded SSC.

A healthy relationship between a chief executive and those to whom that position reports should always be focused on building the capabilities of the individual and the organisation. The culture of performance management must be built to embed this value. Even if a chief executive is struggling in a position, the performance monitoring and follow-up should be centred firmly on this value. A failing executive, although perhaps a poor fit for a particular job, is not a failing human being. The relationship is likely to be terminated soon but this should be done with care and concern for the rights and interests of the individual and the employer.

Commitments to these values and skills in top personnel management do not come naturally with the policy analysts and administrators who typically have the jobs of monitoring performance information. Further, policy and monitoring ministries sometimes seek to shift blame from themselves for poor policy frameworks by unreasonably criticising the agencies charged with the implementation of their policies. Where monitoring encroaches on the review of the personal performance of individual chief executives, it has to be done by mature people with the wisdom of experience in executive positions and not by policy analysts and administrators.

The issue of the SSC's span of control must be confronted squarely. It has never been seen as practical for the SSC, or at least the state services commissioner in person, to undertake the assessment of performance in the same manner and to the same depth as would be expected between a board and a chief executive in the private sector. The state services commissioner's span of control is far too wide for anything other than the formal assessment of chief executives' prescribed external accountabilities. The emphasis on self-assessment and peer review is obviously intended to address the problem, but these are surely inadequate. The state services commissioner has appointed a deputy commissioner to assist in managing chief executives. If this works well, appointments of other deputy commissioners will be made.

Mentoring

The state services commissioner is required to recommend appointments and re-appointments, or otherwise, to enter into contracts of employment, assess performance, provide mentoring and guidance, arrange developmental opportunities and deal with any other situations that may arise. In doing so, the state services commissioner is mandated to protect and

promote the professionalism and political neutrality of the public service. This is asking too much of any one person. The Boston report recommended a return to a three-person commission so that the workload could be shared.

As noted earlier, the state services commissioner has appointed a deputy commissioner with the intention of sharing this workload. This should help, but may still be an insufficient resource to work with the 36 chief executives. Part-time commissioners with experience in top management should be considered as an option. These people could be appointed from the ranks of former chief executives or business people with a good appreciation of the public service environment and the relevant skills and experience. An alternative would be to use such people as contracted employees, but either way they must have the necessary standing to be respected as equals by the chief executives, rather than be seen as civil servants who lack top management experience.

For their part, many chief executives might welcome such a change. In 1993, a sample of 17 chief executives was asked if there was a need for them to be given any more training and guidance about the requirements of their positions. Responses confirmed that, at that time, there was no systematic induction or training of chief executives in their new responsibilities, a situation that was commented on by the chief executives themselves with a mixture of concern and incredulity.¹⁸⁶

Other chief executives will almost certainly resent and resist any expansion of the SSC's ongoing capacity to monitor and assess their performance, seeing it as an intrusion on their managerial autonomy and on their central accountability to their minister. The Logan group and Schick recorded such concerns, but neither review accepted the concerns as valid. The problem is that at least some chief executives do not see the performance assessment process as enhancing their own professional development. Merging the requirements of external accountability with the principles of good developmental personnel management into a single process run by a single body is a challenge that remains to be met. Today, however, the SSC is embarking on a renewed effort to achieve this.

Private sector chief executives in well-run companies have a relationship with the chair of the board that provides mentoring, opportunities to discuss and plan personal and professional development, and other kinds of necessary support. In some cases in the public sector, former chief executives

¹⁸⁶ John Roseveare, *The Independent Responsibilities of Departmental Chief Executives*, Master of Public Policy Research Paper, Victoria University of Wellington, 1994.

have been engaged as mentors for chief executives who appear to have some difficulty meeting the requirements of their jobs. This offers a more intensive level of intervention and assistance than the state services commissioner can provide, and may be more acceptable to the chief executive concerned because it separates assessment from development. But, at the moment, this happens by exception in cases where clear performance problems are in evidence. A wider approach to appointing senior individuals to undertake this mentoring role should be considered, perhaps without linking it so explicitly to problem performance.

Handling poor performance

The essence of New Zealand's core state sector reforms is to associate performance with an individual, rather than with a programme or an institution. This is why the Cave Creek inquiry's excessive emphasis on the system as a whole was so unsatisfactory. The chief executive is personally accountable for the performance of the organisation. Twelve years of experience have brought out the details of how to give effect to this accountability in a way that is robust, reasonable and fair both to individuals and to the public interest. In an environment where performance is multi-dimensional and difficult to measure, and information asymmetries are rife, the SSC is charged with making considered judgements about an individual's performance. In order to send the right signals through the system as a whole, the SSC must be seen to respond positively when it judges that an individual is an outstanding manager, and equally it must be seen to act quickly when it judges that performance is seriously unsatisfactory. In the intermediate majority of cases, the SSC should be focused on developmental activities based on high-quality feedback.

Performance assessment should not be a debate between the parties. It is the process by which the employer forms a sound judgement that, subject to the law and due process, should be final. The SSC has occasionally been presented with difficulties when there is a wide divergence of views about the performance of a chief executive. The minister may have one view, while the others with whom the department interacts take a different view. Such a chief executive might argue that satisfying the minister is sufficient evidence that a good job is being done. There is only limited merit in this argument. For the reasons implicit in the complex accountability networks, views besides the minister's are to be taken seriously. As well, objective data on performance against purchase agreements and levels of efficiency and effectiveness is essential.

It can be particularly difficult to make a judgement on performance in circumstances where the central agencies and their ministers have a view that the minister responsible for the department, and thus the chief executive in question, finds it convenient to have a weak chief executive who is not a source of free and frank advice about the minister's policy preferences. The record shows that these problems tend to sort themselves out over time as ministerial portfolios are shuffled or the evidence of poor performance is brought home to the minister politically. However, the time this can take is costly to the public and to the wider interests of the public service.

I believe that the SSC's mandate for dealing with performance issues should be strengthened. Evolving emphasis on the performance of chief executives as servants of the government as a whole, rather than just their particular minister, implies that the problems of a poorly performing chief executive have an effect outside the immediate confines of the department. The state services commissioner must have a strong mandate from the prime minister, matched with a requirement to ensure that all government departments are, at all times, in the hands of competent chief executives. This means accepting the potential political unpleasantness when poorly performing senior executives are publicly removed, and the possibility of action in the Employment Court, which could require ministers to appear as witnesses. However, in the longer term, the quality of public administration is served by the SSC facing up to these problems as they occur, with careful processes and due regard to the rights of the individuals involved. The alternative of waiting out the remainder of an incumbent's term, or waiting until the poor performance is highly visible, will rarely be in the public interest.

The way in which severance is handled has major implications for the environment of incentives in which chief executives work. It is, therefore, imperative that the SSC has a well-known record for careful, effective and discreet handling of performance problems. Anyone applying for a chief executive position does so in the knowledge that they will probably work for several ministers who are unknown to them at the time they apply for the job. They must, therefore, look to the SSC for a demonstrated record of fair and principled handling of performance issues. An important and positive feature of a chief executive's employment conditions should be that they look ultimately to the SSC, and not to the minister, for due process and final judgement about their performance.

The SSC should, if it has not already done so, review in detail the history of the poor performing chief executives that it has had to deal with since the

passing of the State Sector Act 1988 . This review should examine the causes of the poor performance, such as:

- was it a failure in the appointment process that did not detect weaknesses that should have been apparent?
- did the environment shift and leave a competent chief executive in a situation that they could not manage?
- was the chief executive undermined by the environment that affected their ability to perform? and
- were there personal circumstances causing a deterioration that might have been detected earlier and addressed before performance failure became serious?

Processes and procedures should be adapted if this study was to indicate better ways to manage the chief executives.

One continuing problem is the chief executive who is competent as a manager but who fails to produce sound policy advice. Where it is undesirable to split the management and policy functions, the SSC needs to be much more sharp in defining the policy responsibility and in encouraging better performance in this area.

No-fault severance

The relationship between minister and chief executive is subtle and complex, particularly when the chief executive is called upon to give a good deal of policy and tactical advice or the department is handling politically sensitive issues. Effectiveness for both parties requires that they have an excellent working relationship. The Logan group referred to the relationship as “a managerial relationship in a political environment”¹⁸⁷ while Schick described the “fuzziness ... inherent in an arrangement that assigns political risk to the minister and managerial risk to the chief executive”¹⁸⁸ and both may be called to account.

It is inevitable that sometimes the necessary chemistry between chief executives and ministers is missing. If one of the parties has to go, generally it will not be the minister. Only one of the parties has been placed in their position by a process of democratic selection. The prime minister and the state services commissioner must deal personally with such situations. Only

¹⁸⁷ Logan, *op cit*, p 7.

¹⁸⁸ Schick, *op cit*, p 42.

in unusual circumstances would the appropriate solution be to change the minister. These issues are discussed in detail in chapter six.

The employment contract for chief executives recognises the potential relationship difficulties that can arise by including a provision to deal with situations where an irrevocable breakdown in the chief executive–minister relationship has occurred. If the chief executive concerned cannot be placed in an alternative position, on no less favourable employment conditions, then their contract can be terminated and compensation paid. The Boston report suggested that this provision should be expanded to require that the state services commissioner place the chief executive concerned in alternative employment for at least two years. Most chief executives would refuse to be parked like this and would exercise their rights to redundancy, because their job would have changed in a material way, or they may prefer to accept a clean start in a new role under another contract.

The payment of severance to top executives making negotiated exits has been very problematical and has attracted strong public disapproval. Some of the problems have arisen because of the size of payments and because of some of the circumstances. The current government has stated that it wants to reduce or eliminate payouts. By directing the SSC to insert clauses into all contracts saying that no redundancy or severance payments will be made under any circumstances to senior public servants, the government would be being totally inconsistent with general employment law and practice. It would be unjust to those who have been wrongly treated by their state employers.

Whatever the contractual provision, however, it is clearly better that potential problems are dealt with before drastic action is required. This adds weight to the argument that having access to a wider range of people to provide support to chief executives would be helpful.

Finally, no-fault severance should mean exactly what it says. The SSC and the government should, as far as possible, preserve the reputation and employment prospects of a person leaving or moving to another job in such circumstances. This avenue for removal of a chief executive should never be used as an easy route to deal with a performance problem. People who consider taking these top jobs need to be assured that, in the unlikely event of this happening, it is not terminal to their careers, unpleasant though the experience may be at the time.

THE DEVELOPMENT OF FUTURE CHIEF EXECUTIVES

Because it is likely that most chief executive appointments will continue to be made from inside the public service, it is critically important that effective arrangements exist for the development of the chief executives of the future. The public service should be able to develop such candidates, even if many only progress to senior positions below chief executive. The talent pool from which the top layers of managers are drawn rests ultimately on the total system of bringing new recruits into the public service.

The variation between the best and the worst practices in this regard is far too wide. Best practice is well known and established. The Treasury and the Ministry of Foreign Affairs and Trade have for decades had close relationships with the educational institutions from which they draw their young professionals. Taking the economics profession as an example, the prospect of working in the Treasury or the Reserve Bank of New Zealand is well established as the way to become a seasoned professional in the field. Most economics departments advise their graduate students of the job opportunities available and steer top students in the direction of these jobs. The recruitment processes in the Treasury are intensive and require candidates to make written and verbal presentations. There are also summer intern programmes and support for students, together with programmes that are targeted on recruiting students from ethnic minorities, all aimed at expanding access to superior human resources. It is, therefore, no coincidence that after two decades of recruiting in this way, a number of senior Treasury officials have been promoted to the leadership of other government organisations.

The Logan review group saw management development as the critical senior management issue facing the public service. This was partly because the senior executive service concept had failed to provide a satisfactory framework for an effective service-wide approach to the development of management in the context of a decentralised management system.¹⁸⁹

At the time of the Logan report, and later, departments had been preoccupied with restructuring and establishing new accountability relationships, including a more hands-off relationship with the SSC. This was not a promising environment for the development of the senior executive service, particularly because the role of the SSC in controlling salaries and in training senior executive service members was seen as an

¹⁸⁹ Logan, *op cit*, p 75.

unwelcome return to centralised personnel management. Also, the respective roles of chief executives and the SSC had not been defined clearly and there was no service-wide framework for identifying the needs of managers or their developmental requirements.

Logan advocated the immediate creation of a management development policy across the public service. The state services commissioner would be responsible for assuring the government that processes were in place, service-wide, to ensure a continuing supply of managers of the highest quality. Chief executives would remain the employers of staff in their departments but would be tasked with implementing the service-wide policy and of developing their managers with a view to future positions in the wider public service.

The Schick review reiterated the vital importance of a continuing supply of trained and public-spirited managers. He suggested that, although the senior executive service concept had failed, the objectives were as valid now as they had been in 1988. These were:

- to provide a pool of management talent;
- to encourage mobility across departments;
- to provide recognition and encouragement to managers with potential; and
- to provide a unifying force at the senior levels of the service with a sound appreciation of the best of its values and traditions.

I believe that the case for a strong commitment to the development of existing members of the senior management group is beyond question. It is also apparent from the obvious difficulty that the state services commissioner has experienced in finding a range of suitable candidates for some positions, and from the long delays that have been experienced in some cases before appointments have been made, that more action is needed in this key area. However, despite the acknowledged importance of the issue, progress has been slow.

A steering group of chief executives was set up soon after the Logan review group reported. The group constructed a framework for management development that included the establishment of a Management Development Centre to be managed by an elected board of chief executives.

The centre was formally established and provided with an initial grant by the SSC in 1994, but an executive director was not appointed until August 1995.

The centre focuses on:

- delivering services in the areas of brokering information about courses, secondment, and other opportunities;
- developing agreed core competencies for second-tier departmental managers that take account of the competencies for chief executives and offer a basis for identifying suitable expectations and challenging opportunities for staff with the potential to develop further;
- advising chief executives on customised succession plans and on other possible elements in such plans;
- providing seminars, workshops, and information about conferences;
- commissioning relevant research; and
- establishing the profile and credibility of the centre.

All chief executives agreed to become subscribing members of the centre, but departments have been free to proceed with management development initiatives of their own. Some chief executives have indicated they are not fully satisfied with the centre, although a survey of its members suggested reasonable levels of support.

Whether the work of the Management Development Centre and the efforts of individual chief executives will ensure the rapid growth of top management remains to be seen. These initiatives are necessary but not sufficient, and the centre is vulnerable to the indifference of chief executives. It must work to develop comprehensive philosophies and methods for advanced training and development of senior managers. There is also a budgetary issue involved. Chief executives face tight restrictions on spending, and expenditure on human capital development for the future is easily cut back. This issue must be addressed openly, through better information and stronger commitment to the advancing of the government's ownership interests, as discussed in chapter eight.

Chief executives are, in general, obligated to develop their own staff for positions in their current departments. This must be balanced with the assurance that the development needs of the top management group as a whole are being met. This ought to be an automatic part of the performance requirements for chief executives. All chief executives have to balance the imperative to maximise this year's performance against the need for the development of future management potential. A focus on training on the job helps to avoid the problem of taking key staff out of the office for long periods of training. While external training has a place, it is notable that the

private sector has become increasingly sceptical of long programmes of off-site management training. The more effective philosophy is to have the chief executive in the role of coach, mentor and trainer so that conflicts between production and human capital development are reduced.

The SSC, exercising its expectation of chief executives in terms of the government's ownership interests, should introduce such concepts formally. Subsequent performance assessments should give weight to the efforts that chief executives have made in this area. The chief executives need some incentives to make the allocation of their precious time required by these objectives if they are to meet the future human resource requirements of the government.

CONCLUSION: AN INTEGRATED APPROACH TO TOP PERSONNEL

There is considerable synergy between the work needed to develop the ownership dimension of management and the improvement of the top personnel management systems.

The SSC should make the development and implementation of this integrated top personnel management strategy its top priority. There are a number of topics that should be included.

The competency model for senior executives should be updated, including how it is applied in the identification of management potential, recruitment, management development and remuneration. It also has application in the work on enhancing the ownership interests of government.

The remuneration system should be administered with less ministerial involvement. It needs to provide rewards and incentives that enable the state services commissioner to attract suitably qualified candidates for chief executive positions from both inside and outside the public service.

Consideration could be given to augmenting the SSC further, possibly including provision for part-time commissioners beyond the recently appointed deputy commissioner, which would enable a high level of competence and reputation behind the monitoring and support to be provided to all chief executives. The recent initiative to improve the co-ordination between the central agencies in the monitoring and assessment processes is a most desirable step.

The specification and assessment of the performance of chief executives could be improved, with attention being given to high-quality specification, costing and benchmarking against best practices. More systematic

assessments could be made of departments' delivery against purchase agreements and levels of efficiency and effectiveness. Assessment requires more focus from the many monitoring agencies to make the most of their ability to provide valuable incentives for performance. It also requires staff with sufficient skills to undertake this work well.

Reasonable and specific expectations should be created with the chief executives for the development of senior staff, on the basis of an agreed system-wide philosophy for management development. There needs to be sufficient resources applied to this, through the budgets of departments and attention to their human resource strategies. There should be an ability to assess easily whether senior management capacity is being grown rapidly enough to meet future demands on the public service. The SSC should establish expectations and indicators for the development of human resources in industries and departments.

These areas of work could be incorporated in the performance agreement of the state services commissioner.

There has been too much talk for too long about the importance of developing future leaders in the public service and too much handwringing about the lack of top quality candidates for jobs. The problem risks becoming critical and should be addressed by whatever means it requires.

APPENDIX: SUMMARY OF CHIEF EXECUTIVE COMPETENCY MODEL¹⁹⁰

Competency – Building and sustaining relationships

Description

Concerned with establishing and maintaining positive working relationships with people at all levels within the public and private sectors, related industry and community interest groups and the wider national and interest groups.

Competency – Commitment to achievement

Description

Concerned with a personal commitment to excellence and a focus on attaining organisational goals and objectives.

Competency – Effective communication

Description

Concerned with clear and effective two-way communication with a wide range of people in all situations, in order to explain, persuade, convince, and influence others.

Competency – Honesty and integrity

Description

Concerned with modelling the highest standards of personal, professional and institutional behaviour and helping to ensure a politically impartial and honest public service.

Competency – Intellectual capacity

Description

Concerned with valuing and applying intellectual processes within a well-defined coherent and politically impartial framework, to come to an understanding of a work situation, task, problem, opportunity, or body of knowledge.

Competency – Management of people

Description

Concerned with maximising the quality and contributions of staff to achieve the department's goals and objectives, now and in the future.

¹⁹⁰ State Services Commission, *New Zealand Public Service Chief Executives' Competencies*, Wellington, October, 1994.

Competency – Managerial experience

Description

Concerned with a sound understanding and effective application of best management practices to achieve organisational goals and objectives.

Competency – Strategic leadership

Description

Concerned with forward thinking, seeking and accepting challenges and opportunities and developing and communicating a clear, inspiring and relevant direction for the department.

Competency – Managing in the political–cultural context

Description

Concerned with having the ability to understand the conventions, structure, functions and objectives of government, and the wider cultural, economic and social environment in which it operates, and positioning the department accordingly.

Summary of Appointment Procedures for Departmental Chief Executives¹⁹¹

- i A vacancy occurs as a result of retirement, resignation, or new department.
- ii The vacancy and job/person specification are discussed with the minister of state services and the relevant portfolio minister. Ministers advise the state services commissioner on how they see the nature of the job and what sort of skills and experience are required. The commissioner prepares a paper for consideration by the Cabinet Appointments and Honours Committee, attaching the job description and person specification and raising any other matters to be taken into account in making the appointment. The commissioner also asks the relevant portfolio minister about the composition of the selection panel.
- iii The vacancy is advertised by the SSC in the main New Zealand newspapers, *State Sector Circular*, and sometimes overseas, generally in Australia, Canada and the United Kingdom.
- iv A private sector consultant is often used to assist with the initial screening of applicants. Close consultation is maintained with the commissioner throughout the process.
- v An initial list of applicants is reduced to about the ten best. Those ten applicants are screened more thoroughly and then the commissioner decides a final short-list of the best candidates.
- vi An interview panel is convened. The State Sector Act 1988 requires the inclusion of the commissioner, the deputy commissioner, and one or more other persons appointed by the commissioner. Generally, the panel includes at least one person with a good knowledge of the specific area of the appointment, a person with the equivalent of chief executive experience, and perhaps another person. In most cases panels only deal with one appointment.
- vii The panel considers, and interviews, the best candidates – usually three or four persons. The aim is to reach unanimous agreement as to the best person. However, it is the commissioner's responsibility to decide on the person to be recommended for appointment.
- viii The name of the person recommended is forwarded to the minister of state services, who advises the relevant portfolio minister and refers the

¹⁹¹ Boston *et al*, *op cit*, p 101.

recommendation to a cabinet committee for consideration, currently the Cabinet Appointments and Honours Committee. The committee's decision is then referred to the cabinet and the Governor-General in Council.

- ix The Governor-General in Council decides whether to accept or reject the recommendation. In practice, of course, it is a cabinet decision.
- x If the recommendation is accepted, the commissioner makes the appointment and obtains approval from the minister of state services and the prime minister concerning the conditions of appointment. If it is not accepted, either the government makes its own appointment or the commissioner recommences the selection process.

Salaries for Heads of Departments/Branches of the State Services, 1 December, 1986^a

<i>Salary</i>	<i>Position or department</i>
NZ\$83,325	Government Computing Tourism and Publicity Valuation Women's Affairs
NZ\$96,250	Conservation Customs Environment Forestry Government Life Housing Internal Affairs Lands and Survey Maori Affairs Prime Minister Public Trust Rural Banking and Finance Statistics

NZ\$101,750	Agriculture and Fisheries Defence Forest Service Inland Revenue Labour Parliamentary Counsel Office Social Welfare State Insurance Trade and Industry Transport
NZ\$107,250	Crown Law Education Energy Foreign Affairs Health Justice Science and Industrial Research Works and Development
NZ\$115,500	Post Office Railways The Treasury

^a *Higher Salaries Commission General Review*, 1 December, 1986.

Public Service and Related Chief Executives' Remuneration as at 30 June, 2000 by \$10,000 bands^a

<i>Salary^b</i>	<i>Department</i>
\$150,000 to \$159,999	Ministry of Cultural Affairs ^{c, d}
\$180,000 to \$189,999	Ministry of Pacific Island Affairs
\$180,000 to \$189,999	Ministry of Youth Affairs ^e
\$180,000 to \$189,999	Parliamentary Service ^f
\$190,000 to \$199,999	Ministry of Women's Affairs
\$200,000 to \$209,999	Department of Child, Youth and Family Services ^g
\$210,000 to \$219,999	New Zealand Customs Service ^h
\$210,000 to \$219,999	Ministry of Housing
\$210,000 to \$219,999	National Library of New Zealand

\$220,000 to \$229,999	Department for Courts
\$220,000 to \$229,999	Ministry for the Environment
\$230,000 to \$239,999	Ministry of Fisheries
\$230,000 to \$239,999	Serious Fraud Office
\$240,000 to \$249,999	Ministry of Defence ⁱ
\$240,000 to \$249,999	Education Review Office
\$240,000 to \$249,999	Department of Internal Affairs
\$240,000 to \$249,999	Department of Work and Income New Zealand
\$250,000 to \$259,999	Ministry of Research, Science and Technology
\$260,000 to \$269,999	Ministry of Justice
\$260,000 to \$269,999	Land Information New Zealand
\$260,000 to \$269,999	Public Trust Office
\$260,000 to \$269,999	Statistics New Zealand ^j
\$260,000 to \$269,999	Ministry of Transport
\$270,000 to \$279,999	Ministry of Agriculture and Forestry
\$270,000 to \$279,999	Department of Conservation
\$270,000 to \$279,999	State Services Commissioner ^k
\$280,000 to \$289,999	Department of Corrections
\$280,000 to \$289,999	Ministry of Social Policy ^{l, m}
\$290,000 to \$299,999	Ministry of Foreign Affairs and Trade ⁿ
\$300,000 to \$309,999	Ministry of Commerce ^o
\$300,000 to \$309,999	Ministry of Education
\$300,000 to \$309,999	Ministry of Health
\$310,000 to \$319,999	Inland Revenue Department ^p
\$310,000 to \$319,999	Department of Prime Minister and Cabinet
\$390,000 to \$399,999	The Treasury

^a State Services Commission, *Annual Report for the Year Ended 30 June 2000*.

^b Sums represent annual remuneration packages, plus superannuation and performance incentives where paid. A chief executive who served part of 1999/2000 will have received a proportion of the annual package. Generally, performance incentives are paid in the year following that for which they are applicable.

^c Operates under the title Ministry for Culture and Heritage.

^d As at 30/6/00 the chief executive of the Ministry of Cultural Affairs was an acting chief executive. The sum reflects remuneration for the previous permanent chief executive.

^e As at 30/6/00, the chief executive of the Ministry of Youth Affairs was an acting chief executive. The sum reflects the remuneration for the previous permanent chief executive.

^f The Parliamentary Service is not part of the public service. However, for the year ending 30 June, 2000, the Parliamentary Service Act 1985 applied. It specifies that the conditions of employment of the general manager be determined by agreement between the state services commissioner and the general manager, subject to the agreement of the Parliamentary Service Commission. Under the Parliamentary Service Act 2000, from 1 July 2000 the remuneration for the position of general manager of the Parliamentary Service will be set by the Higher Salaries Commission and will not be subject to the chief executive remuneration policy operated by the state services commissioner.

^g The Department of Child, Youth and Family Services came into existence, formally, on 1/10/1999. The chief executive served part of 1999/2000.

^h As at 30/6/00, the chief executive of the New Zealand Customs Service was an acting chief executive. The sum reflects the remuneration for the previous permanent chief executive.

ⁱ Chief executive served part of 1999/2000.

^j As at 30/6/00, the chief executive of Statistics New Zealand was an acting chief executive. The sum reflects the remuneration for the previous permanent chief executive.

^k Remuneration for the state services commissioner is under the jurisdiction of the Higher Salaries Commission. Sum included for completeness.

^l Operates under the title Ministry of Social Policy.

^m The chief executive is not receiving any extra remuneration for undertaking the role of chair of the Fire Service Commission.

ⁿ Chief executive served part of 1999/2000.

^o Operates under the title Ministry of Economic Development.

^p As at 30/6/00, the chief executive of the Inland Revenue Department was an acting chief executive. The sum reflects the remuneration for the previous permanent chief executive.

CROWN ENTITIES

INTRODUCTION

The term Crown entity applies to a varied collection of public organisations in New Zealand. Crown entities are neither state-owned enterprises nor government departments. They conduct a broad range of activities from relatively minor roles to major functions in the government's portfolio. These activities include provision of policy advice to ministers, provision of services to the public, administration of rules and regulations, occupational regulation and monitoring of other government entities. A list of Crown entities appears in Appendix A at the end of this chapter.

By any measure, the Crown entities are of enormous importance to the public sector and to New Zealand as a whole. In aggregate, they control \$17,000 million in assets and have revenues totalling \$9,000 million per year.¹⁹² There are approximately 80 Crown entities individually listed in the Public Finance Act 1989 as well as references to other Crown entities in acts related to areas such as health and education.¹⁹³ Large numbers of Crown entities, some of which manage huge resources, significantly influence the delivery and allocation of services to the public in the health and education sectors. For instance, the former hospital enterprises, known as Hospital and Health Services, had an accumulated expenditure of NZ\$3.5 billion.

This chapter begins with general concepts for considering Crown entities. It reviews significant features of Crown entities and current problems. An initiative to address some issues taken by the government in 1999/2000 is discussed. The chapter concludes with suggested directions for attention.

ANALYSING CROWN ENTITIES

Crown entities are not the offspring of any single coherent policy or managerial framework, as with SOEs and departments. The frameworks for SOEs and departments have been adapted to some Crown entities in a practical but piecemeal way. For example, purchase agreements like those for departments apply to some, while most have statements of intent that are

¹⁹² *Report of the Controller and Auditor-General on Governance Issues in Crown Entities*, New Zealand Government, November, 1996.

¹⁹³ For example, there are over 2,000 school boards.

similar to the statements of corporate intent used in SOEs. Unique systems have been developed for others, such as the educational institutions where the Education Review Office was created to monitor schools. Any general approach to analysing Crown entities must account for this diversity.

It is useful conceptually to approach the analysis of Crown entities from the perspective of institutional economics, law and good practice in governance and management. Any entity is a web of specific relationships between owners, other stakeholders, the board if there is one, the chief executive, employees, associated service providers, customers, and users or beneficiaries. Within these relationships there are transactions of many kinds: setting strategy, allocating resources, producing and distributing services, receiving payments for them, monitoring performance and producing information. Theory and experience show that effectiveness is improved if there is attention to detail in the assignment of roles, the nature and scope of property rights (including decision rights), and the rights of users, citizens and others to be consulted or involved in decision making.

No formal principles have been adopted by the government that define the conditions appropriate for the creation of a Crown entity to undertake a particular role instead of a department, or, in the case of service provision to consumers, an SOE. A former minister of state services, the Rt Hon Simon Upton, has suggested that ministers should be able to state clearly why an activity should not be located in a government department, or SOE in the case of commercial activities, rather than set up as a Crown entity.¹⁹⁴ Some work was undertaken by the SSC in 1999 and 2000 to categorise Crown entities according to their functions with accountability regimes to match.¹⁹⁵

Some Crown entities are simply an agent of the government and do its bidding within the law. Other Crown entities have responsibilities that are deliberately at a distance from ministers and that are protected from the interventions of ministers. Many commissions with independent powers of investigation and advice are in this category. Some have requirements to respond on behalf of the people directly, which may cut across the interests

¹⁹⁴ Rt Hon Simon Upton, former minister of state services, "Shaping the Future State Sector: Balancing Service, Accountability and Efficiency", speech to the New Zealand Legal Research Foundation conference, September, 2000.

¹⁹⁵ Crown Agents that give effect to government policy; Autonomous Crown Entities that have regard to policy of the government of the day; Independent Crown Entities some of which are quasi-judicial or investigative; Crown Companies with commercial activities within the framework of the Companies Act 1993. SSC, *Crown Entities Governance*, August 2000.

of the government. The developments to policy in 1999 and 2000, discussed below, draw this distinction.

Some entities are located within a network of other public institutions that are jointly responsible for the same policy. The Hospital and Health Services (and now the District Health Boards), for example, are part of a network of government institutions involved in decisions about health services. To understand how well this is operating and how to make improvements, the network needs to be analysed as a whole in addition to considering only the issues affecting the performance of particular organisations.

In all these cases, the challenge of designing a Crown entity remains the same. Roles, relationships, accountability mechanisms, property and decision rights, information flows, resources and the incentives that these create largely determine the effectiveness of the entity over time. Within these frameworks of relationships and incentives, performance is also influenced by human factors, particularly the skills and orientations of ministers, boards and chief executives.

The government owns Crown entities in the terms defined in chapter eight and, therefore, has rights to direct them unless constrained by law. The way these rights are exercised has enormous implications for performance through the effects on the factors above. For example, a lack of structure and principle in the way that these rights are exercised can diffuse responsibility and accountability and even debilitate an organisation. It also affects the credibility and reputations of the organisation and the policy it serves.

This approach to thinking about the design of Crown entities provides the backdrop to the following discussion. In seeking improvements for the future, the government's challenge is to learn from theory and experience and to propose changes that can enhance the performance of Crown entities as instruments of public policy.

THE LEGISLATIVE AND GENERAL ADMINISTRATIVE PROVISIONS FOR CROWN ENTITIES

Crown entities have, in general, been created by specific acts of parliament. The law often sets out unique arrangements for the governance, accountability and financing of the entities. General provisions in the Public Finance Act 1989 also control them. A comparison of the similarities and differences of Crown entities from the SOE and departmental frameworks helps in understanding the situation with Crown entities.

The State-Owned Enterprises Act 1986 established clear principles for the trading enterprises of government that were quickly backed by the necessary machinery of governance, management, policy and monitoring. The key features of SOEs are that:

- they provide services to consumers;
- there is no dominant government purchase interest involved;
- they have clear commercial objectives;
- they are commercially managed;
- they typically have boards with commercial experience;
- they have extensive delegations over the management of the business;
- they operate in competition with any privately owned firms that wish to compete; and
- there is usually a path for eventual privatisation.

By contrast, some Crown entities are monopoly providers of regulatory services, for example the Commerce Commission and the Teachers' Registration Board. Others provide advocacy services such as the health and disability commissioner and the race relations conciliator. Most are funded from the general taxes, but some are not, such as the Alcohol Advisory Council of New Zealand which is funded through alcohol taxes.

Many Crown entities do not have clear commercial objectives at all and those that do have them mixed in with non-commercial objectives.

In sectors where Crown entities are providers of services, such as the health and education sectors, the government acts as the funder or purchaser of services rather than the consumers being purchasers directly, as happens with SOEs. Often there is little or no competition in the market for these services because the government purchasing policies exclude private providers for practical or ideological reasons. The forces of competition and consumer choice cannot be employed to create incentives for efficiency and effectiveness. The potential for inefficiencies in operations to arise and the danger of excessive influence on policy by these monopolistic organisations can be counterbalanced by the government's framework for accountability and performance management. This framework can create controls and incentives for efficiency and effectiveness. These incentives have to be embedded within the management systems and culture of the organisations. As the funder and purchaser, the government must deal with the problems of arriving at requirements for service delivery and setting prices. It must monitor the services being provided. The external frameworks and internal

cultures are hard to get right. Most problems in Crown entity performance stem from weakness in these areas.

There are five key differences between government departments and Crown entities:

- Government departments are governed by chief executives who report to their ministers, with the SSC playing a role in their employment, while Crown entities have a variety of governance structures including politically appointed boards.
- The SSC is not directly involved in the appointment process of the entity's chair of the board or the department's chief executive officer, although it must be consulted over the terms and conditions of employment of chief executive officers. The entities ignore the SSC advice only rarely and this provision is being reinforced since cabinet decisions made in 1999.
- Some Crown entities have the capacity to raise debts, unlike government departments.
- There are also perceptions, somewhat overdrawn, regarding differences between Crown entities and departments in their degree of political independence, the quality of their management and the nature of the roles they undertake.
- The accountability systems around Crown entities are varied and in many cases under-developed compared with departments (and SOEs) and have tended to be a hybrid of both forms.

The Public Finance Act 1989 extended the government's control over Crown entities in a series of steps in the 1990s. Whereas one framework fitted all departments quite well, the same was not the case for the Crown entities, or at least it was not clear what such a framework should be at the time the Act was passed.

When the Public Finance Act 1989 was first developed, a complication arose from the provision that the government's accounts would be kept in accordance with Generally Accepted Accounting Principles (GAAP). According to these, an organisation is defined as part of the government if it is owned by the government. As noted in chapter eight, the question of who owns a Crown entity depends on who carries the residual financial claims, amongst other factors. The relevant accounting doctrines are concerned with the substance rather than the form of the relationship between the Crown and its constituent entities.

This raised a problem because there were strong political constituencies around some organisations where the government had acknowledged de facto liability for residual financial claims. There would have been strong resistance to the notion that the organisations were, in any sense, owned by the government. For example, a strict interpretation of GAAP might have included many producer boards. Around the time that the Public Finance Act 1989 was being drafted, the Kiwifruit Marketing Board went into one of its periodic financial crises. There were fresh memories of the 1986 budget, which made provision for \$1,450 million in producer board debt.

The government attempted to deal with this by including a definition of Crown entities in the Public Finance Act 1989, but it also added a schedule that included an initial list of entities that were evidently Crown-owned and the provision that others could be added by order in council. It also provided for delay in putting those provisions into effect in view of the uncertainty about them.

Over subsequent years the law was modified several times to refine the definitions of Crown entities and to extend the general framework of public management across them. Appendix B describes these steps in detail and the issues that were debated over several years. The government was, again, considering the legislation for Crown entities in 2000, as discussed below.

The Public Finance Act 1989 requires Crown entities to produce a statement of intent that is tabled in parliament by their minister. An SSC review of these documents found that many did not comply with legal requirements, many had inadequate financial information and many failed to provide sufficient information to assess performance.¹⁹⁶ There is clearly room for ministers, monitors and Crown entities themselves to seek improvements.

The nature of the relationship between Crown entities and the ministries that advise the ministers to whom the entities report has been a major legal issue. An opinion of the Crown Law Office in 1997 implies that money spent by a Crown entity outside the services described in its accountability documents is a form of expenditure by the department in whose portfolio the entity appears. As a consequence, the departments whose entities are funded through the votes they administer are taking a closer interest in them. In order to do this in a way that promotes the performance of the entities, rather than ties them up in red tape, regimes of accountability have to be devised

¹⁹⁶ State Services Commission, *Crown Entities Review of Statements of Intent*, Occasional Paper 20, September, 1999.

that balance the requirements for freedom and accountability. These can be more complex than the equivalent regimes for SOEs.

The success or failure of the Crown entity initiative begun in 1999 will hinge on whether it leads to a stable, clear framework of accountability that finds the best balance of freedom and central control and monitoring. It should apply sound principles, backed by the lessons of experience. The framework should also investigate closely the areas where performance problems have been most significant and examine the influence of the policy frameworks. A new legislative framework was being developed in 2000 that may address some issues, but the preparatory work indicates that further work is required to avoid introducing new problems and leaving significant gaps.

THE INDEPENDENCE OF CROWN ENTITIES

A common justification for creating Crown entities is the substance, or perception, of greater independence from ministerial direction by comparison with departmental heads. The presence of a board in many Crown entities, as a governance layer between the minister and the chief executive, contributes to the perception that Crown entities have a greater degree of independence from political intervention in the management of their affairs. The separate legal form of a Crown entity does indeed give the appearance of independence. The practice has been that the entities are more independent generally than departments, but this is not immutable or inherent in the organisational form.

There is, in general, a greater degree of formality in the modes of ministerial influence in a Crown entity, although the problems in 1999 in the New Zealand Tourism Board and the Fire Services Commission show that there are exceptions to this. In these cases, ministers intervened deeply into the affairs of these organisations. A Crown entity can, and should, require a minister to put an instruction in writing where the issue is of great significance and the board is convinced that the proposed course of action is a mistake. This is not uncommon. It creates an inhibition for ministers to direct something that they are not prepared to make public or for which they will wear the risks.

There is more than one concept of independence in question here, which reflects the tension between freedom for managers and boards and ministerial accountability. Crown entities are more independent than departments in terms of management freedoms but this is counter-balanced by it being easier for ministers to change the people appointed to the top

positions. The boards of Crown entities are more easily dispensed with than a department head, sometimes for reasons that would not be sufficient for the dismissal of a senior civil servant. Although board members of Crown entities have appointment letters with terms of office, they really serve at the pleasure of ministers. This has been clarified by the review of Crown entity policy. Crown entity board members have sometimes assumed a greater degree of independence for their entities than ministers have generally conceded in reality. Crown entity chairs are often robust and experienced individuals who are not as acculturated to taking instructions as public servants. While they enjoy the confidence of the government they can appear to act very independently, but this does not change the underlying reality of ministerial control and accountability.

The minister is answerable to parliament for the actions of a Crown entity. This includes actions taken under delegation by boards and managers. Parliament does not expect ministers to manage organisations. They do, however, have a constitutional obligation to parliament to investigate and put things right that are plainly wrong, or to head off emerging risks by intervening in whatever way is most effective, legal and follows the precedents of good practice in the circumstances. In general, this means seeking explanations, ensuring that boards and managers get on top of the problems and fix them, or if they do not, appointing other people.

The practice of ministerial accountability is unlikely to differ whether major failure occurs in a Crown entity or in a government department. The minister of health was called to account politically in 1998 when kidney dialysis was denied to a dying patient, even though there were three links in the chain of accountability between the minister and the citizen in question. These were two Crown entities (the HFA and a CHE) and an independent clinical decision maker whose decision was backed up by peer review. In addition, the Human Rights Commission, the race relations conciliator and the Courts were involved in reviewing the decision making. When the Accident Compensation Corporation (ACC) revealed serious problems in its senior management in 1996, the minister in charge appeared before the select committee with the chair of the board.

There are no laws restricting the amount of detail that a minister can enter into in the performance requirements of the Crown entity. It is quite conceivable that a government department could be assigned roles and freedoms and have a relationship with ministers that amounted to a great degree of independence. This could be more independent than a Crown

entity with a board, whose minister imposed a lot of detail in the accountability documents, was uninhibited in issuing formal directions to the organisation on matters great and small, and expected to be consulted in much of its decision making. It is, therefore, possible for a particular Crown entity to be less independent than a particular government department, depending on the approach taken by ministers.

Independence based in statute is as likely to lie with a departmental official as with a Crown entity. Some civil servants carry the title of commissioner and there are also officers of parliament, both of whom have greater independence than many Crown entities. Similarly, the independent powers of some Crown entities are prescribed specifically in the legislation that establishes them, rather than in any laws concerning general public sector management. The Police Complaints Authority, the privacy commissioner and the Commerce Commission are examples. The Commerce Commission and the commissioner of Inland Revenue have similar degrees of independence even though one is a Crown entity and the other is a government department. In both cases their independence is prescribed in the enacting legislation.

While ministers have control over the budgets of these independent Crown entities, the processes for appointing commissioners means that they do not simply serve at the pleasure of ministers. As an illustration, the state services commissioner can only be dismissed through a complicated process involving consultation with parliament.

Instances of real or perceived conflicts in the accountability of Crown entities sometimes arise. School principals, for example, sometimes assert that they are accountable to parliament under the Education Act 1989 and resist the wishes of ministers and the interventions of the Ministry of Education.

There is evidence of some Crown entities holding strongly to positions in the face of pressure from the government. There is not, however, something inherent in the constitution or functioning of Crown entities that means they are necessarily more independent than government departments. Rather, their independence is variously established in statute, earned via the competence of the organisation and the standing of their leadership, or results from a hands-off style on the part of the minister. Broadly, the same applies to departments. The principle of accountability of ministers is unaffected by the creation of Crown entities.

The Virgin in a condom: a case study in the independence of a Crown entity

The Museum of New Zealand Te Papa Tongarewa became involved in considerable controversy in 1998. Three exhibits caused offence to individuals and Christian groups. One was a small statue of the Virgin encased in a condom, a second was a painting resembling Leonardo da Vinci's *The Last Supper* with a naked woman in the position of Christ, and the third was a set of erotic postcards from early New Zealand collections. Religious groups, including non-Christian groups, took deep offence at the 'Virgin in a condom' exhibit and mounted peaceful protests at the exhibition. Anti-Christian groups staged counter protests. The chief censor examined the propriety of the postcards and found them to be inoffensive.

The management of the museum shielded themselves behind the argument of freedom of artistic expression. The chairman of the board said that the board should not make judgements about artistic merit. The management also refused to respond to questions about whether they would support exhibits that offended the Maori community by saying they would not answer hypothetical questions. From this it appears that the museum had no policies on the question raised and did not see the need for them.

Under its enabling legislation, the museum has the purpose of presenting, exploring and preserving the heritage of our cultures and the knowledge of the natural environment to better:

- understand and treasure the past;
- enrich the present; and
- meet the challenges of the future.

In so doing, the board of the museum is required to endeavour to ensure that the museum expresses and recognises the mana and significance of Maori, European and other major traditions and cultural heritages. It must also endeavour to ensure that the museum is 'a source of pride for all New Zealanders'.

These are taxing requirements when put alongside the habits of artists to extend the boundaries of culture by calling into question beliefs, myths, icons and other aspects of tradition. It is certainly questionable whether government and parliament contemplated that the legal mandate for this Crown entity extended to offending the religious beliefs of many people and creating such anger in the community. It is the right of private individuals and institutions to do so, but unlikely to be considered a right of a publicly funded museum. It was clear that the museum was not intended to be a

collection of boring traditional exhibits. Its mandate above, does, in my opinion, include re-interpretation of, and challenge to, traditional ways of seeing things. But I think it put its foot on the wrong side of the line in setting up an exhibition that would predictably offend a substantial segment of the community for no higher purpose or principle, it transpired, than the rights of staff to enjoy freedom of artistic judgement.

The museum, having got itself into this situation, would have done more damage by bowing to protest and withdrawing the exhibition than in continuing with it. It is better that the museum has a reputation for independence in its judgement, and even for making a few errors of judgement, than having a reputation for bowing to the loudest voices of objection to its decisions. The minister concerned could have intervened but would also have been caught in a dilemma. The experience has left in the minds of one section of the community the inference that aspects of their culture are not to be understood, treasured or enriched, but only challenged. We shall see over time whether this incident is implicitly regarded as an error in hindsight or whether it will be balanced either by exhibits that other sections of the community find equally offensive or by other perspectives on Christian culture. The government, which is ultimately accountable for the museum, could have helped by making more clear what its views on the museum's mandate were and, therefore, its position on the controversy.

These comments are made from the perspective of public management principles. Others have debated the episode in aesthetic or cultural terms.¹⁹⁷ One thing is clear on the topic of the relative independence of Crown entities and departments. This Crown entity, in particular, with its enabling legislation has been able to push boundaries in the public arena further than any government department could have done, and further too than those entities that are to be classified as 'agents of the Crown' under the 1999 Crown entity initiative discussed below.

This situation may, however, not be permanent. Early in 2000 the prime minister, who holds the portfolio of arts and culture, linked the government's response to a request from the museum for more funds to a change in its aesthetic judgements. She is quoted as saying¹⁹⁸ that the museum would have to address some issues before additional funding was granted. The prime minister said that part of the core mission of the museum was

¹⁹⁷ See, for example, "Virgin in a Condom: Storm in a Teacup?", *Victoria Quarterly*, Victoria University of Wellington, Winter 1998.

¹⁹⁸ *The Dominion*, 25 January, 2000, p 2.

adequate display of the country's art and heritage collections and that she was concerned that most expert art critics believed that the museum did not do that. "There have been quite devastating critiques ... we are entitled to require, on behalf of the public, that we make sure it receives critical acclaim", she said.

To be fair to the museum, there have also been many complimentary reviews by professionals.¹⁹⁹ However, the prime minister's statements indicate some re-balancing of the decision rights of management, the board and ministers. The chairman of the board appeared to acknowledge this. When asked if he was afraid that the government will use the money issue as a lever to changing the museum's exhibition policy, he is quoted as saying that he is happy to discuss the policy with the museum's shareholder, the minister.²⁰⁰

Independence over advice and political activities

The longstanding tradition amongst outstanding public servants to provide free and frank advice to ministers is related to the question of independence. The expectation of such advice was contained in a direction to department heads from the prime minister in 1988. However, the 1999 Labour/Alliance government demonstrated an unwillingness to consider advice that runs against its policies.²⁰¹ Aside from entities with specific advisory functions, there is no equivalent obligation on the boards of Crown entities to provide frank, high quality advice, although most assume this role.

Departments are expected to be scrupulous about avoiding involvement in political activity. It is difficult to define exactly what political activity means, but in practice experienced civil servants have no difficulty in knowing where the boundary between political and administrative functions lies. The strictures on Crown entities about promulgating publicly their views on government policy are not as clear. In contrast to departments, some Crown entities publicly state their position on political issues, sometimes in conflict with the minister. Examples are hospitals that publicly opposed certain rationing and funding decisions in health, and universities that opposed student fees in education.

¹⁹⁹ Stated by the chairman of the museum board, Sir Ronald Trotter, *Sunday Star-Times*, 30 January, 2000, p C3.

²⁰⁰ *Sunday Star-Times*, *loc cit*.

²⁰¹ See for example *The Dominion*, 4 October, 2000, p 11.

Some Crown entities are expected to engage in activities, such as advocacy and consumer representation, in a way that would be prohibited for a government department and SOE. School boards of trustees, school principals, university councils and the former Regional Health Authorities have assumed roles in representing various constituencies within the political process. The universities are given the role in statute of being 'a critic and conscience of society'. One regional health authority clearly saw its role on certain issues as including lobbying government. Some entities are required to conduct elaborate consultative processes that engage them in hot political debate. These can cause friction if the government is launching initiatives on the same topics. In 1999, the HFA found itself in this situation when its surveys of needs for hospital-based health services raised questions about the location of the regional hospital in Wellington when the government had already signalled its intention about addressing this.

The comparison of Crown entities with SOEs is useful. In general, SOEs are freer than Crown entities, under the principles of the State Sector Act 1988, to engage in political activities. Over the years many SOEs have claimed that they have the freedom that private sector companies have to press their views and the organisation's commercial interests politically. Some experiences have emerged that help delineate the limits. The electricity state-owned enterprise, ECNZ, lobbied openly and vigorously over almost ten years to stop the policies to break it up and introduce competition into electricity generation. The government did not seem to mind although it did eventually break up the corporation in the late 1990s.

The forestry SOE, Timberlands, was the subject of a book²⁰² that accused the SOE of funding organisations to lobby politically and of engaging a public relations firm to be very active in seeking to influence ministers, officials and public opinion in favour of logging native trees. All this was denied or interpreted benignly by Timberlands, but some of the behaviours described in the book, if they occurred, are way over the line for an SOE. The first public reactions from ministers were very relaxed and drew on the principle that an SOE is to behave like a private sector company. The chairman of Timberlands made a series of statements that pointed out the duties of the board and the company that justified their actions. His situation was complicated by the fact that an election was imminent and the opposition, although split internally on the issue, was opposed to the policy of logging native trees. The chairman also had to deal with the opposition by the government's political

²⁰² Nicky Hager and Bob Burton, *Secrets and Lies*, Craig Potton Publishing, Nelson, 1999.

opponents to the legitimate attempt by the company to use the normal processes under the Resource Management Act 1991 to get permission to log the forests.

Alleged political activities by the company were thus debated in volatile circumstances. A public relations catastrophe struck the company two months after the election when a general manager of the company, Kit Richards, posted a message on a web site with advice that the only chance to reverse the policy (to stop logging native forests) "is to put real heat on Clark (the prime minister) and Hodgson (the minister with responsibility for the SOE) personally ... unless their fingers are burnt, they are not going to change".²⁰³ The prime minister said that it was outrageous for Mr Richards to be engaged in highly political activity while he was employed in a public sector organisation and she challenged the board to explain why Richards should continue to be employed. This time the board did not attempt to defend the actions of the company. The chairman stated that "the Timberlands board totally disagrees with this type of behaviour. It is inconsistent with the moral and ethical standards that we as a board would expect of the organisation".²⁰⁴ Richards lost his job. The position he espoused was, however, that any embarrassment was inadvertent, that he was expressing options to fight for a programme he thought could be successful, that he gave his views to anyone who asked him and that he knew his message would be public. The whole story behind the incident has probably yet to be revealed and will provide a useful case study in the limits on SOEs in attempting to influence government policy.

A point that seems to be overlooked is that SOEs are like wholly owned subsidiaries in the private sector where one would be in a lot of trouble for taking overt political action to pressure the shareholder contrary to its wider interests. In the public sector, the expectation should be that SOEs give forthright advice freely within the privileged access they have to the government but, unlike private companies, not to engage in any other activity to persuade the government to a particular point of view. Crown entities should stay inside the same boundaries unless their statutes or government directions set them up to go beyond such boundaries. The health and disabilities commissioner plainly has an obligation to criticise inadequacies in the government's health policies that can have very political ramifications.

²⁰³ Quoted in *Sunday Star-Times*, 30 January, 2000, p A8.

²⁰⁴ *The Dominion*, 28 January, 2000, p 2.

MIXING COMMERCIAL AND NON-COMMERCIAL OBJECTIVES

In the second phase of corporatisation policy after the 1990 election, the government created hybrid corporate forms of organisations that had a mixture of commercial and non-commercial goals. Examples are the Crown research institutes that are required to meet both commercial and science goals. Mixed and often conflicting objectives add great complexity to the accountability, governance and management frameworks of these entities by comparison with SOEs. Unless these systems are sound they also add great risk to the consumers of their services and to the taxpayers who fund them.

The 1985 SOE reform model was not designed to address the complexities of multiple and often conflicting roles. The original SOE policy was to separate out social objectives and to fund them separately. Subsidies for loss-making passenger transport services are an example.

Crown entities have become the norm for government-owned social service providers. An example is the public hospitals, which have over the past five years steadily evolved through legislative and administrative change away from having commercial objectives like SOEs to being accountable to the government through several channels for delivery on a detailed performance specification covering ownership, purchase and other interests of government.

Health is a particularly complicated story in this regard because the government is everywhere in the sector with a variety of different and conflicting interests. The search for stable, reliable institutional arrangements to expose trade-offs and make intelligent decisions has gone on for years and will go on for years yet.

Relationships between the former hospital boards and Area Health Boards and the central government were fraught with problems. Investment decisions were often poor, plant was run down and services were biased towards hospital care and against primary and community care. The health reforms in the early 1990s had the superficial appearance of a purchaser-provider split and of competitive pressures for efficiency and service quality, but were never a clean application of this concept. There has always been central political management of the relationships between publicly owned purchasers and providers. Competitive forces were very muted either by policy directions or by the reality of monopoly provision of many services. The public hospitals have, in many respects, presented the government with an unsatisfactory mix of a commercial governance model with strong central planning of services. Twenty-three companies were

created without a mechanism to reallocate capital between them over time or lower costs through sharing of services, thereby avoiding needless duplication. Given the policy that evolved, rather than the one that was originally intended, it would have been preferable to have a holding company over the hospitals. The power of the owner of all the hospitals could have been better used to promote rationalisation, improved efficiency and mergers. Ministers, acting as the government shareholders, lacked the information and support required to stimulate these developments.

While the requirement for these hospital enterprises to operate as successful businesses was removed from the law in 1997, the directors still had extensive legal obligations under the Companies Act 1993 which could potentially see them in conflict with government priorities. For example, a hospital might want to accelerate its exit from a loss-making service before other arrangements could be set up. This was contrary to the exit protocols required by government and the government's hospital services plan that guaranteed that existing facilities would endure and that stopped rationalisation. This problem of conflicting obligations often resulted in explicit undertakings and indemnities from shareholding ministers. The 1999 Labour/Alliance government formulated legislation that has converted hospitals from Crown-owned companies into District Health Boards with elected and appointed board members. This change will introduce new accountability and financial problems.

The problem of conflict between the commercial responsibilities of directors in Crown-owned companies and the social objectives set out in legislation or in directives to the companies also appears in the housing and science sectors.²⁰⁵

The following quote from David Brosnan, former employee of Housing New Zealand and the SSC, in an article in the journal *Public Sector* captures this issue:

It is in my view questionable whether the COE (Crown owned entity) model is capable over the longer term of accommodating the government of the day's political interests and objectives in housing in a manner that is consistent with the functions and accountabilities of a board of directors constituted under the Companies Act 1993 and the legislative requirement to operate HNZ as a successful business.²⁰⁶

²⁰⁵ Peter McKinley, "Crown Entities: A Reflection", *Public Sector*, Vol (3), September, 1997, pp 2-5.

²⁰⁶ David Brosnan, "Housing New Zealand as a Case Study of the Crown-owned Entity Model", *Public Sector*, Vol (20), No 3, September, 1997, pp 6-9.

This issue needs to be carefully examined in the context of the advantages and disadvantages of alternative forms of organisation. There may be little gained in imposing the Companies Act 1993 obligations on directors if the government makes it difficult for them to meet those obligations, then manages the situation by providing indemnities and undertakings.

Conflicting objectives are inherent in the whole concept of Crown entities because these conflicts arise in the policies they administer and this makes the entities difficult to govern and manage. For some, there are needless contradictions in their mandates that should be removed through adjustments to the policies they administer. For many Crown entities the conflicts must be addressed through careful application of the conceptual approach sketched earlier in this chapter.

FINANCIAL FREEDOMS

Some Crown entities are given powers to raise debt and to make investments, which departments are not permitted to do, and this is sometimes used to justify the creation of a Crown entity. There is an appearance that the financial risk associated with this debt is removed from the government because the Public Finance Act 1989 states that the Crown is not liable for Crown entity debts. However, the government cannot remove itself from this risk unless it is willing to allow the entity to cease activities in the event of financial failure. The government would also suffer damage to its own reputation in financial markets if institutional lenders to government bodies were not at least partially indemnified if there was a financial failure. The sagas of the Bank of New Zealand and the Development Finance Corporation in the 1980s proved this point. Both were government-owned financial institutions that went bankrupt with a damaging effect on the government's financial reputation.

When an early Crown research institute failed financially, it was wound up. It was a small entity and its work was redistributed to other entities. Generally, however, the government does not allow significant entities to fail and this creates an implicit government guarantee for those dealing with the entity. For example, financial markets clearly regard loans to CHEs as government guaranteed.

Because the Crown's own cost of capital is lower than the cost of capital of any one of its constituent entities, there is a cost to this private sector debt that is higher than managing it within the consolidated Crown debt. Whether this cost is justified will depend on any benefits realised with specific arrangements around capital and investment management for the

entity that would not be available through administrative requirements on the Crown entities. One possibility is that the private lender has superior capacity to evaluate and monitor the investment proposal but, because of the implicit guarantee, lenders have weak incentives to monitor the risks.

The implicit government guarantee and the lack of exposure to personal risk on the part of employees and directors because of indemnities can create conditions where entities take more risk than they should. Counterbalancing this is the degree of intervention by the government to shape, slow down or prohibit decisions that boards and managers would otherwise take in line with private sector practice. Directors often have a fair claim for indemnification because they are restrained from taking decisions that would protect the capital in the Crown entity. Further, they are often pressed by government to take decisions that strain their better judgement. There are no simple rules to balance the responsibilities of directors under company law with responsiveness to ministers. This provides further reason to undertake deeper analysis of the Crown entities and revise the design of the frameworks around them.

QUALITY OF MANAGEMENT AND PERSONNEL

A further reason that is advanced for creating Crown entities is the ability to attract a wider range and higher quality of people to participate in their activities than is possible for a government department, especially at the level of chief executive. From my experience as chairman of three Crown entities, I think it is possible within definite limits to attract people from the private sector into chief executive positions who would not consider applying for a job heading a government department. This is about culture as well as money. In fact, the Crown entities have been required to consult the SSC on chief executive salaries and they think twice at least before ignoring the advice they get. The 1999 initiative will tighten up this requirement to consult so that it will be rare for an entity to pay a salary outside what is acceptable in the SSC's view, or to offer other benefits to chief executives such as redundancy rights that are beyond the norm acceptable to the SSC.

Also, it is argued that Crown entities are able to run themselves in a more business-like manner and develop stronger cultures of performance than is possible within the bureaucratic culture of a government department. There may be some truth to these points, because Crown entities have a little more flexibility than do departments in their employment and remuneration practices with regard to chief executives at least. The degree of flexibility,

however, does vary and a review of this has been recommended by the auditor-general.²⁰⁷

Certainly the long squeeze on top executive remuneration in departments has had an adverse impact on some departments' abilities to retain quality staff in the face of competition from private sector firms, coupled with some unattractive features of public sector employment. Crown entities have been less affected by such restrictions and a little more able to mitigate some of the unpopular aspects of the public sector culture. This can give them an edge over departments in competing for human resources. This is cause for reflection on the State Sector Act 1988 and the way that it is administered. Some departments have roles at least as significant as Crown entities. There is no justification for significant differences in the ability to acquire human resources between departments and Crown entities. A substantial differential would distort the choice between a departmental form or a Crown entity form.

More generally, there is no reason why it should be accepted that departments will settle for a lesser quality of management than Crown entities. This has not been the case to date and some departments can and do out-perform Crown entities. The 1999 Crown entity initiative is at a cross-road in the sense that it moves to tighten up on the Crown entities. It could, as a worst case, force the entities to the lowest common denominator. The opportunity should be taken to tidy up loose ends in the Crown entities, and to strengthen, not weaken, the provisions that promote performance, rather than focusing on the imposition of controls. This would require improvement in the processes and principles of performance management and accountability as discussed below.

USING CROWN ENTITIES FOR POLITICAL ENTRENCHMENT OF A SERVICE

Ministers may choose Crown entities to secure the longevity of their policies. A study by Horn²⁰⁸ predicts that this is what a minister might do in the interests of making it difficult for future legislators to remove the embedded policies. It is more difficult for future politicians to abandon the policy in

²⁰⁷ *Report of the Controller and Auditor-General on Governance Issues in Crown Entities*, November, 1996.

²⁰⁸ Murray J Horn, *The Political Economy of Public Administration – Institutional Choice in the Public Sector*, Cambridge University Press, Cambridge, 1995.

place if there is an institution with some statutory independence lobbying within government for the continuation of the policies and its own existence. Over many years the Accident Compensation Corporation was effective in protecting its position within the corridors of power by this means. A small portion of its services that were privatised in 1999 has been reversed following the election of the 1999 Labour/Alliance government, largely for philosophical reasons. During the short competitive era the corporation made large reductions in costs.

The Earthquake Commission is an example of the government using an institution to embed an undertaking to the citizens about the availability of its support in the event of an earthquake damaging their property. The commission collects levies as a tax on private insurance policies and is obliged to pay out in the event that earthquake damage occurs. But the government has a greater capacity for managing the risk and meeting contingencies in the event of an earthquake than does this institution. The government could simply use bookkeeping methods to earmark funds and assess and record contingent liabilities in its financial statements. Whether it sets aside financial assets to match some of that contingency or relies on its capacity for borrowing in the event of a large pay-out would be seen as a component of the government's total financial management approach. There would seem to be no justification for the existence of the Earthquake Commission as an independent financial organisation, other than as a symbol of credible commitment to the earthquake policy. Proponents of the present commission would have to argue that the existence of the commission adds greater certainty and credibility to the obligations on the government to pay for earthquake damage and that these benefits outweigh the extra costs of the commission's existence.

The entrenchment of policies in powerful public institutions can be a problem if it inhibits review, evaluation and modification of the policy. The Crown entity may also be captured. For example, occupational regulations are probably distorted in favour of professional interests when the regulations are administered by a Crown entity staffed with practising members of the occupational group.

The evidence that Crown entities entrench policies more strongly than departments is missing. While universities, hospitals and schools appear to have such effects, one of the most powerfully entrenched public organisations ever, the Ministry of Works and Development, was abolished. The four Regional Health Authorities were abolished after a few years and the HFA that replaced them was abolished in 2000. When designing Crown entities this entrenchment argument does not deserve serious consideration.

CROWN ENTITIES AS RESPONSES TO PARTICULAR ISSUES

New Crown entities are sometimes created under urgency to undertake policy, monitoring and oversight functions over sectors where there is unsatisfactory performance. For example, in the health sector there have been four monitoring functions created in recent years. These involved a new role for the National Health Committee, the health and disability commissioner, the mental health commissioner and the Maori health commissioner. These functions have been created in response to public and political concerns over the performance of the health system and the behaviour of its participants.

Given that there will be changes over time in the circumstances that drove the initial creation of any Crown entity, it would be judicious to place sunset clauses on the terms of special purpose entities so they can be reviewed in due course. They should be prevented from becoming permanent fixtures focused on issues that arose years ago if events have moved on.

RELATIONSHIPS OF MINISTERS AND BOARDS

The relationships of Crown entities and ministers are varied. A former state services minister noted that ministers and chairpersons of boards have to sit down and talk to give some colour and life to the documented expectations.

Boards should not be seeking to enfold ministers in responsibility for board decisions. Neither should ministers be seeking to encroach on board responsibilities. Both are entitled to know where each other's comfort zones start and stop ...²⁰⁹

As well as the clarification of expectations through discussion, there is much that can be done to improve the more formal aspects of the governance and accountability arrangements for Crown entities.

There is no comprehensive set of principles underpinning the relationships between ministers and boards, although a Cabinet Office Circular in 1999 has briefly set out the roles and powers of ministers in relation to Crown entities. Provisions in the Public Finance Act 1989 leave an ambiguity about the role of the minister in relation to responsibility for a Crown entity's statement of intent. Some Crown entities do not have boards and some are not companies incorporated under the Companies Act 1993. Even for those entities that are incorporated under the Act, it is not possible simply to import the standard requirements of the Companies Act 1993.

²⁰⁹ Rt Hon Simon Upton, speech to New Zealand Legal Research Foundation, *op cit*.

When the HFA, which was not incorporated under company law, reviewed its governance practices, it took account of its empowering legislation and its accountability documents. The duties of directors under the Companies Act 1993 and associated best practices were also considered. These were useful but were not the whole story.

There is no standard framework that can apply to all Crown entities to guide the relationship between ministers and boards. According to the conceptual model above, the governance relationships should be designed to give effect most efficiently to aligning the accountabilities and incentives of the Crown entity with the government's relevant policy objectives. There is also much to be learned from the accumulating case studies on Crown entities that could be codified into good practice.

Trouble at the New Zealand Tourism Board

In 1999, the New Zealand Tourism Board suffered a string of revelations of practices that provide an interesting case study of a Crown entity with some serious problems in management, governance and ministerial interventions and relationships.

The story began with an escalating disagreement between the board and the minister of tourism, the Hon Murray McCully, over the degree of emphasis to be given to promoting mega events such as the rugby world cup, the America's Cup, the Asia Pacific Economic Co-operation (APEC) conference and the millennium celebrations. McCully was a minister with a pattern of difficulty in establishing effective working relationships with public organisations for which he was the minister²¹⁰ but the breakdown over this issue was extraordinary. The board was concerned that the minister's proposals were partly motivated to get a domestic political spin-off, while the board wanted to spend the budget on a global branding strategy. The minister overruled the board on this and other matters and at times issued instructions directly to staff. The board sought legal advice on whether the minister was going beyond his authorities in doing this.

²¹⁰ The situation concerning the administration of housing policy is discussed in chapter five and in *The Dominion*, "Rows Disrupt Housing Line", 1 October, 1997, p 10. There is reference to difficulty in working with ACC in "Labour turns its sights on English", *The Dominion*, 5 May, 1999, p 2. Sudden resignations from his ministerial office and the resignation of the head of the Millennium Office under his portfolio are the subject of the story "Mystery surrounds sudden McCully staff resignations", *Evening Post*, 10 September, 1999, p 3.

In November 1998, a management review was conducted that was critical of management by the board. A significant ingredient in the breakdown was the creation of the Office of Tourism and Sport, which was an unusual organisation set up by McCully to advise him. It is part of the Department of Internal Affairs but reports directly to the minister. The chief executive of the Department of Internal Affairs was formally responsible for advice to the minister but in practice appeared to be sidelined. The Office of Tourism and Sport sought the chairman's severance and was highly critical of the board's work.

The relationships eventually broke down completely and the minister told the board he would sack them if the chairman did not resign. In December 1998, the chairman Mr Mogridge, another board member Mr Wall, and the chief executive were all paid out with sums of money that were very large, concealed initially by confidentiality agreements, and that subsequently attracted much adverse publicity. Another board member, Mr McSweeney, resigned in January 1999 citing constant interference by the minister. He said

... if he (the minister) wants a hands-on approach and thinks he can do it better, why then do we need a board?²¹¹

Following the resignations and an Audit Office inquiry, the new chairman, Peter Allport stated that:

The pressure from the minister and his advisers virtually paralysed the board and prevented the directors from working in the best interests of tourism at a critical time for New Zealand.²¹²

He also said the severance payments had been a practical solution to avoid expensive legal action for 'wrongful termination' of board members and to avoid further damage to the tourism industry.

Throughout the controversy Murray McCully maintained that he was trying to address his concerns about the performance of the board with the backing of some sections of the industry. He said:

In the latter part of last year there were some concerns about performance issues. I didn't take them up publicly, but I certainly took them up privately.²¹³

A ministerial colleague, the Hon Bill English, defended McCully in these terms:

²¹¹ *Evening Post*, 1 February, 1999, p 1.

²¹² *Evening Post*, 22 April, 1999, p 1.

²¹³ *Evening Post*, 1 February, 1999, p 1.

... where people share objectives, he's good to work with; where they don't he's more assertive than most politicians at getting people to line up ... It's to do with having a pretty clear idea of what he wants to do, and using the tools of the system to achieve it.²¹⁴

The auditor-general conducted an inquiry that found that the severance payments to the board members were unlawful because the minister did not obtain the approval of the minister of state services and the board had no jurisdiction over severance payments because they were not employees of the board. The minister did not direct that the payments were made but:

... it seems to have been accepted by all concerned that if Messrs Mogridge and Wall were to be sacrificed in the interests of the whole board they should be compensated for their premature resignations.²¹⁵

The auditor-general's report also stated that there should be no expectation of payments for board members for premature resignation.

The auditor-general discussed at length the governance issues, particularly those caused by lack of knowledge and agreement among the parties about their roles. He also pinpointed inconsistencies between the board's duties to parliament as an independent statutory body and the minister's control through the purchase agreement under the Public Finance Act 1989. The parties did not understand the content of a purchase agreement or the process for arriving at one.

On the release of the report, the minister told parliament that the report found him guilty of 'parking ticket' misdemeanours but there was no hanging offence. He accepted that not checking on whether the severance payments were legal was an error of judgement but said he would not resign. He did resign a few days later, although the prime minister said there was no reason for him to do so as she did not believe that the report showed that the minister had acted inappropriately.²¹⁶ McCully stated, however, that:

I sensed that she believed that this was the right decision (but) she and other colleagues certainly have done nothing to try to promote any decision I wouldn't be comfortable with.

He explained his resignation in terms of:

²¹⁴ *The Dominion*, 22 April, 1999, p 12.

²¹⁵ *Report of the Controller and Auditor-General, Inquiry into Certain Events Concerning The New Zealand Tourism Board*, Wellington, 19 April, 1999, p 6.

²¹⁶ *The Dominion*, 28 April, 1999, p 2.

A big picture judgement call that there is going to be a better chance of getting people to look forward if they have a new minister.²¹⁷

The government promptly launched its Crown entities initiative.

Although the events attracted great controversy the lessons that can be drawn from it are few and were already well known before the breakdown. The key lessons are as follows.

Mr McSweeney is generally correct that, if the government wants to have hands-on control of a function it should not put it into a Crown entity. After all, there is no point in having a dog and barking yourself. In the details of the relationship with any specific Crown entity, the minister will want to establish with the board how they will want to exercise their ultimate powers of direction. Expectations should be clear in advance so that boards are not constantly wondering what they are, or are not, allowed to do. Boards cannot be held accountable for decisions taken by ministers against the board's judgement but the board is accountable for implementing these decisions. Whatever is agreed between ministers and Crown entities should be reflected in the statement of intent tabled in parliament because this instrument captures the Crown entity's accountability under the law.

The defence of Murray McCully by Bill English as quoted above effectively says that he has good relationships with organisations that share his objectives and that do what he wants, otherwise he uses the 'tools' of the system to get his way. The principles for governance of Crown entities that were imported from the wider public management system emphasise clarity of roles and decision rights. They prescribe but also proscribe the means by which ministerial will is exerted. Not all disagreements between a minister and a Crown entity should be resolved by the imposition of the minister's preferences.

Ministers should get their way primarily by setting strategic directions, negotiating budgets and accountability requirements, and monitoring performance against these. A minister can also appoint people to vacancies on boards or dismiss non-performing individual board members or boards. These are the 'tools' in question and they confer on a minister who knows how to use them more than enough power to get an entity to strive to achieve the requirements of parliament and the government. The formality and transparency of these tools contributes to efficiency and effectiveness over time, even though ministers may not always be getting everything they want. This formality is also an assurance for the public that Crown entities,

²¹⁷ *The Dominion*, 28 April, 1999, p 1.

particularly those dispensing huge sums of money, are not infected by political patronage.

A minister should not bypass the board of a Crown entity and give directions to the staff. As a practical matter, because board members are part-time and typically meet monthly, the chief executive or other top managers of a Crown entity will have meetings with the minister when the chair or other board members are absent. The manager should accept directions from the minister on behalf of the board in these circumstances because:

- the direction is pursuant to established directions to the board contained in formal accountability documents; or
- the matter is within the manager's discretion from the board and the manager agrees with the minister's view; or
- as above, but the manager disagrees with the minister but does not see the matter as sufficiently significant to escalate to a board–minister discussion.

If the manager disagrees with the minister's direction and it is not prescribed in formal accountability documents, then the manager must inform the minister that the matter must be discussed with the board.

There are prescribed processes and conventions for removing board members who the government thinks are not performing. Telling some board members that they will lose their jobs if they do not get rid of the chair is not one of them. As the auditor-general said, board members are not employees of other board members.

The letter of appointment for board members of Crown entities has a term and attached conditions and is a contract for services. The two Tourism Board members who were paid severance are, however, the only Crown entity board members I am aware of who thought this contract entitled them to a severance payment. The Crown entity initiative has codified that it does not, as most already knew from experiences such as the termination of all the Regional Health Authority boards in 1997.

Because the government imposes obligations on its constituent organisations to be a 'good employer' it should be careful about making the conditions of engagement and its obligations to its appointees clear. In its own interests, the government should be concerned about creating disincentives for people it might want to accept as board appointments. The onus is on the chair to build a constructive relationship with the minister, but there is also a reciprocal obligation on the minister. From my experiences on boards, I am sure that chairs and other board members accept that when the relationship is not satisfactory the government has the right to change them,

because they are political appointees without the protections of the State Sector Act 1988. But, in return, the government must accept the responsibility of wanting a change publicly and must not use backdoor methods to push people out with unsubstantiated inferences of performance issues.

The kinds of people that governments want in senior board positions have a lot to lose in terms of reputation and income if a severance leaves them unfairly damaged. I do not know what the performance of the Tourism Board was. I am concerned, though, that the normal processes I would expect to see to address a minister's concerns over the performance of a board and its chair did not occur. Also, the auditor-general commented that there was no way of knowing who was right in the issue that was in contention between the minister and the board. This may have been a situation where there was a fundamental disagreement over an issue that was a matter of judgement and an incompatibility between people as the auditor-general implies. If so, then the proper course was a no-fault severance in the manner that has been recognised for departmental chief executives.

The select committee consideration of the application of the Public Finance Act 1989 to Crown entities in 1991 recommended the application of purchase agreements to Crown entities and also recognised that there were potential incompatibilities between this measure and the statutes that created some of the entities. The New Zealand Symphony Orchestra and other situations had shown the problems that can occur when roles and relationships are unclear and accountability principles and documents are in conflict.²¹⁸ In this regard there was an accident waiting to happen with the Tourism Board and the government should have reacted to the warning signs earlier. By the same token, the Tourism Board wandered into a well sign-posted bear trap avoided by many others.

REFINEMENT OF THE CROWN ENTITY FRAMEWORK

A more refined and complete analysis that accounts for the issues discussed above has been overdue for some years. In the wake of the problems of the Tourism Board and some Crown entities the government launched an initiative in 1999 that provides a context in which to raise such issues. The following sections address issues that are, or should be, part of that review.

²¹⁸ The New Zealand Symphony Orchestra situation is discussed later in this chapter.

The government's initiative to improve Crown entities in 1999

In July 1999, the government launched the 'Crown Entities Initiative' to review the management and accountability of Crown entities. It is led by the SSC and its scope is as follows:

To address the identified problems the Crown Entities Initiative will:

- clarify the expectations of key players, particularly through guidelines to Ministers, boards and departments;
- provide quality information on public sector ethos and practice through briefing and induction programmes and board appointment processes;
- issue standards for remuneration of Crown entity boards and employment contracts of chief executives;
- enhance oversight through better disclosure and monitoring processes; and
- introduce legislation to address inconsistent governance arrangements.²¹⁹

While this initiative provides an opportunity to take a comprehensive view and to refine the management framework of Crown entities as a whole, the measures it signals are partial. They are focused on tightening controls by ministers on Crown entities' discretion and on seeking to enhance the public sector ethos in some of them where it may have been lacking. This may reduce the risk of embarrassing affairs like the Tourism Board one but, if taken to the point of being a general and significant loss of freedom to manage within the requirements of law and government policy, it could cause a serious deterioration in performance.

The Crown entity initiative has considered governance issues, mainly in relation to classifying types of entities and making suggestions about the relationships with the government of different types of entities. This work requires further development because it currently lacks some logic in the basis for classification. One puzzle is the conflicting reasoning behind the definition of Crown agents. They are required to "give effect to the policy of the government of the day" and will be used "where a high degree of ministerial control is appropriate" and:²²⁰

- where "it is necessary to achieve a significant delegation of decision-making authority in the allocation of Crown resources to distance

²¹⁹ Crown Entities Initiative, Michael Wintringham, state services commissioner, State Services Commission, Wellington, July 1999.

²²⁰ State Services Commission, *Assignment of Crown Entities to Classes*, Wellington, 2000.

- ministers from sensitive decisions including those involving individuals”; or
- where it is necessary “to limit the scope for ministers to become involved in decision making”; or
 - where a “perception of a close cultural fit with its clients or industry may be necessary to operate successfully”.

Can a high degree of ministerial control sit alongside any of these three situations? I do not think so.

As well as contributing to the development of a better generic governance and accountability framework, the SSC should make sure that governance structures and processes around Crown entities are reviewed to ensure that they are tuned to the performance requirements of each entity. A generic approach will not solve problems rooted in the policy frameworks of a sector. Crown entities also need to be supported by sound practice on the part of boards, ministers and managers. This requires training, benchmarking and continual attention to examples of best practice. Care should be taken not to give excess weight to ready-made approaches in searching for sound governance practices, because it would be easy for boards simply to install standard methods from the Institute of Directors and shortcut the more important consideration of the requirements of specific organisations.

A comprehensive review of the entities is desirable but should be scheduled carefully. There was a previous attempt to do this that did not accomplish much.²²¹ Many Crown entities are long overdue for a thorough reappraisal of the policy objectives that they are designed to achieve and of whether a Crown entity is still the best way to achieve them. If so, a new and more refined structure of accountabilities, incentives, decision rights and information should be instituted to sharpen the performance of organisations. There needs to be policy work on comprehensive principles and practices for the effective functioning of Crown entities and criteria for when this form is likely to be the best choice.

²²¹ A review of so called ‘quangos’ was undertaken during the implementation of the public sector reforms in the late 1980s. The term quango borrowed from the United Kingdom and meaning quasi non-governmental organisations was used to describe many Crown entities in New Zealand. It was unclear to whom they were accountable, who set their functions, who had residual liability for their finances and who owned them in the context of the Public Finance Act 1989. The quango review was undertaken with the expectation that many entities were ineffectual and little would be lost by abolishing or consolidating them. Few were abolished or consolidated.

Policy analysis and evaluation

Poorly analysed policy issues can result in complex roles and inconsistent constraints that are responsible for some of the observed performance problems in Crown entities. In these situations, even the best management is unlikely to produce a positive result due to the inherent contradictions in the agencies' roles, objectives, constraints and operating environments. There have been occasions where the government has created new entities, or reorganised existing entities, as a solution, instead of reviewing the policy frameworks behind its interventions. For example, the health sector has undergone three significant structural reforms since the 1980s and a fourth was begun in 2000, in response to persistent problems in reaching settled conclusions about the fundamental health policy issues. This cannot be explained away as only being the result of ideological differences among ministers, although that is part of the explanation.

Before organisational accountabilities, incentives and structures are determined, the government should set the policy objectives, decide on the role of the government in the Crown entity area, the interventions that are likely to be most effective, and the interests of the government and other parties in the control and delivery of the services. This is very demanding policy work and often over-stretches the capacities of ministers and their advisers. Structural reforms are easier to think about and they create a lot of visible and sometimes rewarding activity for the participants.

By the same token, existing Crown entities should be reviewed in the context of the policies that underlie their existence and in the total environment within which they operate. Such an evaluation of established institutions entails a comprehensive system-wide approach to the policy in question, and recognition that the focusing of attention on a Crown entity in isolation from this wider context risks overlooking factors that are critical to the performance of the entity. For example, the multi-faceted role of the government in the health sector needs to be accounted for in considering the frameworks for the public hospitals.

The Crown entity initiative in its current form would not have averted the problems of finance, costs and quality in the hospital sector as referred to in chapter eight. Tightening up the requirements on statements of intent, or giving guidelines to the Ministry of Health on board appointments, or seeking better specification of outputs in performance agreements, would not have prevented the financial upsets in the health sector. Their cause lay with a flawed policy framework that set up four geographical monopoly purchasers and 23 monopoly hospital providers and that expected them to

achieve productivity gains in the absence of incentives, resources and the freedom to do so.

We can expect the financial performance of hospitals to continue to be troublesome under the Labour/Alliance redesign. With few incentives for district health boards to press their hospitals for prudent management it is easier to lobby for more money than to manage costs and make hard decisions about priorities.

A consideration of the wider settings in the health sector indicates why governments will continue to find their dealings with hospitals taxing. The Ministry of Health is now the funder, the monitor and the purchaser of some services at the district health board level in addition to being the adviser on the ownership issues. Whatever gains in co-ordination this produces, these gains must be discounted and possibly overwhelmed by losses in transparency and capability in balancing potential conflicts between these interests. This invites opportunism by the District Health Boards. No amount of careful induction of board members, monitoring of chief executive salary levels or tight control on fees will solve these problems. As well as financial problems, many hospitals have faced significant quality issues. There is little in the Crown entity initiative that would have addressed the fundamental problems that hospitals faced in the mid 1990s.

Another area where thorough policy analysis is required is in the tertiary education sector. It is very difficult for the government to monitor its ephemeral 'ownership' interests. How can the government assess the levels of investment and funding it wants to apply to this sector when it has little information on performance, including relative costs and capability? The Crown entities initiative sidesteps this sector.

It is the policy framework that determines the operating environment for Crown entities and that has powerful effects on their performance. Where there are serious problems in performance, government advisers must examine the policy framework. Tightening the bolts on a fundamentally faulty structure is not the answer. Leaving out tertiary education and consigning health to circumstances that invite confusion places critical areas of the economy at risk, particularly given the risks of budget blow-outs in health and the lost opportunities from an education sector that fails to take New Zealanders as far forward as its competitors. The Crown entity initiative has its eyes on good housekeeping but overlooks significant problems with policy frameworks in key sectors.

However, not all situations surrounding Crown entities are complex. Simple tools of analysis are plainly preferable where they suffice, but

evaluation methodologies should take account of the fact that many of the areas where Crown entities are present are not amenable to such simple tools.

Clarifying interests, roles, relationships and rights over decisions and property

It is important that thorough examination of the interests, roles and rights that various parties either have, should have, or should not have in any Crown entity precede decisions on whether a Crown entity is appropriate, what legal form it might take, its governance and its accountability. This must go beyond a crude categorisation, such as funder, owner, purchaser and provider, and into the details of the particular roles in question. Reviews of the statements of intent of Crown entities by McKinlay and others show that this has not been done in the past. This is a source of confusion and poor performance in these organisations.

The review I conducted of the New Zealand Symphony Orchestra illustrates the point.²²² In this case the orchestra's performance was being increasingly compromised by confusion over the specific interests and roles of the minister, the Ministry of Cultural Affairs, the board and management. As a result, the contents of the accountability documents were contradictory and were not owned by all the parties. The board presented a statement of intent to the minister for tabling in parliament that the minister did not agree with, but it was forwarded to parliament anyway as the board's document. The purchase agreement with the Ministry of Cultural Affairs did not line up with the board's business plan. The accountability framework was in disarray.

A study by the SSC in 1998 of Crown entities statements of intent indicated that there were many deficiencies in these documents, including some significant failures to comply with the law. The SSC Crown entities initiative considers better specification in these documents, but the problem runs much deeper than poor specification. Shoddy statements of intent indicate that boards, senior management, ministers and select committees do not care too much about them. There is something astray in their incentives if such entities do not have sound statements of intent. If a key accountability document is so disregarded for accountability purposes, this indicates an underground accountability system. Something else matters to ministers, select committees, boards and management – something more akin to

²²² Graham Scott, *A Report on the New Zealand Symphony Orchestra*, New Zealand Symphony Orchestra, Wellington, May, 1996.

performance in a political, rather than business, sense, I would suspect. The Crown entities initiative needs to consider more deeply the reasons underlying the problems with statements of intent.

A generic approach to them can only go so far. A deeper analysis would involve mapping out the interests of the government, setting up the roles of the parties in and around a Crown entity, and ensuring that the governance and accountability framework encouraged the desired behaviours. Obscurity about roles and conflicts should be addressed at this stage, which will often mean revisiting the underlying policy decisions to obtain greater clarity.

As discussed in chapter four, structural separations have powerful effects on shaping the roles and responsibilities of public organisations. Structural separations clarify roles and avoid capture of the functions by special interests or poor management by confusing roles. They expose valuable information flows, help align incentives with policy objectives, and create contestability and alternative sources of advice and services. They facilitate the matching of functions to organisational forms that potentially promote better performance. The benefits of separating roles and devolving authority justified the creation of Crown entities to undertake the administration of schools and hospitals.

Where Crown entities have been created as one component of a structure of government organisations the performance of the entity cannot be judged in isolation from the wider system. Services that require co-operation by several organisations need explicit attention to processes of interaction and strong relationships. The quality of the relationships between organisations, for which they are mutually responsible, will affect their individual performance. In health much effort was put into relationship agreements that governed the transactions between the HFA, the CHEs and the Ministry of Health in the hope of avoiding bureaucratic stalemates and to encourage the search for innovative solutions to conflicts. Clear strategic direction by the government in such areas is also necessary, because the relationships between ministers will usually drive the interactions of their departments and Crown entities. If they do not work well together then their agents will not either.

Politicians and the public are inclined to the view that the discernible friction in the relationships between public sector organisations is a reason for amalgamating them. The Education Review Office annoys schools and the HFA annoyed hospitals and the Ministry of Health so the functions they perform are put at risk. However, the concern for effective inter-agency relationships and the collective culture of the public sector is best met by

focusing on strategy, communications, and joint responsibilities for multi-organisational goals. Shapeless conglomerate organisations that hide the interplay of the conflicting interests of government in a sector may lower the noise level but at the expense of performance.

Health provides an example of the different interests of the public that need to be balanced in a sound and open way for good overall performance in the sector. The public has an interest in getting quality services at a good price and in having hospitals that are more concerned for patients than the interests of the people who work in them. They have an interest in ensuring that, as taxpayers, they are getting good returns on the assets they have paid for. The public wants to know that regulations on providers of health services ensure their safety when they receive health services but do not cause pointless inefficiency, cost and irritation to the people caring for them. They want to know that the quality of advice and service to the minister of health is good and the cost is reasonable. That these interests can conflict is a reality. The public is better off having these interests debated and resolved, even with a bit of noise, than having them glossed over and hidden from view in a shapeless mega-ministry.

In 2000, the Ministry of Health absorbed the roles of CCMAU in the ownership interests of the public hospitals. Simultaneously, the purchase interests of the government, previously with the HFA, were split between elected district health boards and the ministry. In effect, part of the purchase interest was shed to local government and the rest of it merged into the conglomerate ministry. The ministry is not about to debate with itself in public and write critical reports on its performance of the kind it has previously written about purchasing organisations. Nor will it keep up the flow of information that previously informed those debates. Time will tell whether District Health Boards maintain an open exposure of the inevitable tension between their purchase interests in health services and the goals of the hospitals. Unless the boards are very capable, they will be putty in the hands of the hospitals. There is risk to the public that the way in which the government represents and resolves its several interests in health policy will again become obscure so it will be hard to see how the public institutions are really performing and how hard decisions about priorities are being made.

More generally, I think that focused organisational roles and the benefits they bring do not have to be bought at a net cost in terms of system-wide performance and the collective interests of government. By thinking simultaneously about the roles assigned to focused organisations and their incentives, accountabilities and the likely patterns of behaviour between them, higher levels of performance can be obtained from well-functioning

networks than from 1970s conglomerate-style organisations. The evidence from breaking up the old conglomerates like Justice, Works and Development and Agriculture and focusing the Treasury on its core activities supports this. In each case performance has improved from the creation of new single-purpose departments, specialised business units within departments, Crown entities or SOEs with focused roles and objectives and the freedom to manage resources.

There are few universally reliable rules about when various functions are best amalgamated or separated. While the case for separating roles is clear in many specific instances, experience shows that the details and circumstances really do matter in each case. The general rules for identifying and focusing functions should be used to ask questions but not to answer them.

Selecting organisational forms

Against this background, the choice of which of the three main forms of public organisation to use in any case should be able to be made with a degree of confidence. Each of these forms has a comparative advantage in the way it deals with accountability, incentives, governance, advocacy and so on. But each is so flexible that it can be made to do much of what the others were primarily intended for. A department could run a trading enterprise if it had to and an organisation incorporated under company law could function as a policy ministry. One would not want to see either in reality, but it is possible. The issue for the designers of public organisations is to choose a general organisational form on the basis of comparative advantage and then tailor it to suit the specific circumstances. There are also advantages in terms of comprehension and transparency of using standard techniques for this tailoring.

It was once an accepted notion that there should be an identification of the form of public organisation with the dominant interest of the Crown such as ownership, purchase, regulation or transfers. According to this view, for example, the SOE was the preferred form where the dominant interest is ownership. The dominant interest would also be sufficient to identify the policy issues involved. Subsidiary interests would be dealt with by other arrangements such as contracts, subsidies or regulations. In a report to the SSC in 1995 Peter McKinlay rejects this.²²³ He argues that choosing an

²²³ Report for the State Services Commission by McKinlay Douglas Ltd, *Crown Entities: Categories and Principles*, March, 1995. See also McKinlay's later reflections on the topic in *Public Sector*, Vol (3), *op cit*, pp 2–5.

organisational form on that basis risks concealing other interests that are nonetheless very important to the government.

McKinlay argues that placing functions in the legal form of a company, the dominant interest of which is shareholder wealth, creates serious problems if the shareholder embeds other conflicting objectives within that legal structure. The example he uses is the requirement on Crown research institutes to be concerned with the benefit to New Zealand of the way they operate their businesses. This can create serious problems for directors under their duties in company law if a profitable opportunity arises to sell technologies to the foreign competitors of New Zealand firms. It would also create difficulties and confusion with the government's advisers if the Crown research institute failed to meet its financial goals by rejecting profitable opportunities. The issue can be resolved in principle on the basis that the highest price for the technology provides the best benefit for New Zealand, but there will be times when directors and others will question this.

McKinlay concludes that the company legal form causes difficulties when the government has substantial non-profit objectives for organisations that are not clearly expressed in accountability arrangements.

I accept McKinlay's contention that one cannot make the decision about form simply on the basis of the apparent primary interest of the government. A deeper analysis is needed of the alternatives for an organisational design that can be expected to optimise the delivery of the service in question. I do not agree, however, that the company form should always be excluded in circumstances where commercial and non-profit goals are mixed. The choice of a legal form will not resolve the problems of conflicting objectives in many situations because they are embedded in the relevant policy. The problem will remain even if the organisation is in a different legal form. In some circumstances, the duties of directors will provide a useful check on an organisation that is inclined to overrun its budget. Also, there is merit in the use of the legal instruments of company law because of the large body of law and convention that has been established that can be imported into public management. I agree with McKinlay, however, that great care must be taken to express non-commercial objectives in a way that is unambiguous and that promotes transparency about the trade-offs that are made. Where the organisation's objectives are primarily non-commercial, however, there is little point in using the company legal form.

Too often Crown entities have been used as buckets to dump unresolved policy problems into, in the hope that, somehow, the directors and managers will solve in practice the problems that policy analysts and politicians have not been able to solve conceptually. On occasions Crown entities manage to

do this, but boards and managers have sometimes been sacked for not solving problems that lay, not in poor management, but in the faults in the underlying policies.

Examples of these difficult roles can be found in the health and education sectors where the government is involved on both the supply and demand sides. Services are provided to the government or consumers on a non-commercial basis. Without a market clearing mechanism, the agents involved are expected to make detailed decisions on rationing, service coverage, capital allocation, labour issues and production levels. This affects most New Zealanders as consumers, and tens of thousands as employees. It involves multi-billion dollar investments in schools and hospitals.²²⁴ The conflict is driven by budgetary constraint, balanced against demands for increases in services, political pressures at all levels and pressures from interest groups and suppliers. There is a need to work within the government's budget while ensuring that the interests of the public and consumers are responded to.

The challenge is to create organisations that can function well with the capabilities that it is reasonable to expect they will accumulate and not to give them near impossible tasks. Generally people appointed to Crown entity boards have not had experience with the complexities of government, and may not do well where issues arise that require skills in addressing political and policy processes.

Improving governance

The incentives operating on an organisation through its governance and accountability arrangements greatly influence its performance. The accountability frameworks for Crown entities are not well developed and are impacting negatively on the performance of those organisations. Based on an audit of a sample of six entities, the auditor-general's 1996 report raised an extensive list of concerns, some of which are:

- lack of clarity over governance responsibilities;
- confusion in boards over their obligations to the Crown on the one hand and the entity on the other;
- variable levels of effectiveness by ministers in managing relationships with boards;

²²⁴ \$3,082 million in assets in education and \$4,247 million in assets in health. *Report of the Controller and Auditor-General on Governance Issues in Crown Entities*, Appendix 3, New Zealand Government, November, 1996.

- problems with handling of conflicts of interest;
- some boards lobbying political parties and making inappropriate public criticisms of government policy;
- lack of engagement of some ministers in the statement of intent and lack of commitment to it by some Crown entities;
- lack of emphasis on ownership matters in the accountability document;
- conflicts between the accountability documents, for example, a Crown entity could have a conflicting statement of intent and performance agreement;
- failure to use the business planning process to reach a shared understanding of the Crown entity's intentions and the Crown's interests and priorities;
- monitoring regimes did not provide a systematic and comprehensive analysis of risks; and
- boards not clear on when to seek ministerial guidance.

There has been only a piecemeal response to these issues so far. This list of issues deserves careful attention and a response led by the central agencies. The measures announced in August 1999 are only a partial response. The study in question shows a wide range of practices around essential elements of the governance arrangements including requirements to declare interests, the use of formal accountability documents, requirements to be a good employer and the presence of the chief executive and departmental representatives on the boards. While there is no reason to insist on a completely homogeneous approach across all entities, the spread is wider than can possibly be justified and some of the features that emerge in the report are simply examples of poor governance practice.

Problems and improvements are not difficult to define conceptually, although they do involve a lot of work in some cases. For example, the accountability arrangements for the Regional Health Authorities were recognised as being considerably flawed in a study in 1996. Particular problems were a lack of clarity in roles and ways of working that diluted the boards' accountabilities. Later the HFA and the central agencies redesigned the accountability framework for the HFA to improve clarity on what was to be delivered and the roles of the parties. The accountability arrangements centred on a strategic business plan which flowed up into the formal accountability documents and down into the operational accountabilities of management. The government provided a broad statement of health objectives each year that was cycled through detailed internal planning.

Finally, there was a 'statement of service coverage' for health services, which lay at the core of the HFA and government communications with citizens about service availability. This offered a practical way to move performance specification towards service delivery and health outcomes.

This model is similar to the new accountability arrangements being tested for departments and ministries. These arrangements centre on a "Statement of Intent" that is essentially a strategic business plan. The strategic planning process and the resulting accountability documents provide a method for avoiding conflicts between multiple external accountabilities and between external accountabilities and internal management processes, such as those illustrated in the New Zealand Symphony Orchestra situation noted above. These are both recurrent accountability problems around some Crown entities.

As well as considering refinements to the accountability documents, the SSC should carry out work on governance practices. It could codify good practice as part of its work to develop advice for ministers on the expectations of boards.

The process of selecting boards involves a minister taking names to caucus and then on to the honours and appointments committee of cabinet. The selection of names is usually done by informal canvassing in government circles, with suggestions coming from the caucus. With the advent of MMP, this process has become far more complicated because more than one caucus is consulted. When I was appointed as chairman of the HFA in 1997, I was proposed by the minister of health who belonged to the National Party but I was also interviewed by the caucus of the New Zealand First Party that was the minority coalition partner at that time. The preferences of ministers and their colleagues will always be influential in Crown entity appointments but there is scope for improving the process. Positions could be advertised with clear requirements for the role in question as part of the advertisement. A process for short-listing candidates could be developed so that a pre-selection of suitable candidates is made, prior to consideration by politicians. The processes are operated by the relevant ministry or the staff in the minister's office. There would be improvements in the processes by running them through a central organisation serviced by the SSC so as to accumulate a breadth of experience from which to draw best practices. Some advances may be made in the quality of appointments through the use of recently developed guidelines for ministries and ministers. Ministers are required to certify that an appropriate appointment process has been followed. This is accompanied by a description of the

process that is legislated under the Official Information Act 1982. A considerable impediment to selecting high quality boards, however, is the lack of large numbers of people with the required expertise in a small country. This increases the importance of using the talent pool sensibly. It also indicates a need to develop the talent pool.

Once a candidate is selected, they receive a letter of appointment covering their remuneration, the term of the appointment, a brief statement of the minister's expectations and other information. The term means the maximum because most boards serve at the pleasure of ministers and can be changed any time. However, the Crown entities initiative is suggesting that some members may only be dismissed for "just cause". This will restrict the ability of ministers to remove board members. Letters of appointment have been variable in their content. In 1999 the SSC developed advice for ministries that were assisting ministers to appoint boards. That advice covers the appointment and induction process and could lead to improved practices. The guidance, however, is not well developed in the area of best practice principles of governance expected of Crown entities.

Each Crown entity should be required to undertake a periodic review of its governance policies. There should also be self-monitoring of the effectiveness of boards to assess the value of their contribution to organisational performance. I found it useful in initiating self-review of a board to use a facilitator with a sound process for gathering feedback from board members about each other's performance.

Boards also need to think carefully about what subcommittees they should establish. Typically there is an audit and finance committee and a remuneration committee. The former committee oversees the compliance functions and would have direct access to the chief finance officer and internal audit and standards staff. Boards sometimes have other committees focused on particular aspects of the work and strategy of the organisation. For example, the HFA had a performance improvement subcommittee that focused on new developments in service strategies and internal management. In each case, these committees must all respect the authority of the chief executive. It must be understood that board members can only direct staff through the chair and chief executive. It was common under the Area Health Boards in the late 1980s for board members to break this protocol and issue directions to staff below the chief executive. This confused accountability and adversely affected performance.

Private sector governance practice has been through radical changes in thinking over many years under the influences of agency theory and the

work of Michael Jensen and others. The standard practices in some New Zealand boardrooms have been proven to be inadequate in terms of stewardship of shareholder interests. Some companies have not made returns in excess of their cost of capital over the past eight years. In response, many companies have introduced economic value added as a motivator to protect the owner's interest and secure returns on equity. The concept has application particularly in SOEs, but also in Crown entities alongside other specified objectives that capture the other interests of government.

New concepts for aligning the interests of managers and owners of the parties are emerging to address the problems that focus on the roles of the parties, contractual relationships, information and incentives. The SSC should sponsor a study of the relevance of emerging new practices in corporate governance as input to innovation in the governance arrangements for Crown entities.

Organisational development over time

The final dimension of the design of organisational frameworks involving Crown entities is the time dimension. This concerns not only the way a particular scheme will be implemented initially but also what tendencies are built in that will influence the development of the framework over time.

The design of policies must take into account the ability of government agents to implement them. Complex policies may require sophisticated agents to implement them that are not readily created. It is rare for complex institutions that have just been established or substantially changed to perform initially to a high standard. Organisational cultures take time to arise and most Crown entities are unique in some key respects so that they cannot achieve excellence only through imitation and benchmarking. Like organisations everywhere, some will head off in mistaken directions for a while before settling into a pattern that is best adapted to the task and the environment. It usually takes the terms of two or more chief executives in a new organisation before it matures. Unless policies can be simplified or standardised to shorten the time to maturity we may have to be patient while we build entities that are capable of learning and developing new approaches to solving their difficult mandates.

Some mandates have been beyond the capabilities and powers of the Crown entities to deliver and no amount of learning would improve the situation. A significant example concerns the Regional Health Authorities (RHAs) and the CHEs. Simply put, the government set budgets for the RHAs that could only cover the government's commitments to volumes of

hospital-based health services if the hospitals made gains in efficiency that were improbable given the incentives and constraints that were imposed over time, and also if the government met all the costs of reform. Three RHAs and nearly all CHEs suffered financial difficulty partly as a result. Managers in the RHAs and CHEs found themselves in 'negotiations' in which neither party had the financial flexibility to close the gap between them. The resolution of the dilemma in late 1998 required the collaboration of both parties with the ministers of finance and health and their advisers to implement a policy known as the 'deficit switch'. This recognised that some of the capital support of CHEs to cover their losses was, in reality, payment for service delivery, because the RHAs were not funded to pay realistic prices for some services. This was an adjustment to the policy, rather than the outcome of organisational learning in the delivery system.

Some structural arrangements are not intended to last or, at least, turn out that way. The article by Brosnan notes that the creation of Housing New Zealand as an incorporated form was effective in creating a new culture of personalised customer service, better decisions about capital allocation and a drive for results, rather than compliance with processes.²²⁵ While the objectives for the enterprise were primarily commercial, this worked well but with the return to greater ministerial accountability and more emphasis on social objectives, the political and housing objectives of the government became increasingly at odds with the responsibilities of the directors under company law. In Brosnan's view, the different policy environment called for a change in organisational form.

Crown entities do not stay locked into their original configurations. As time moves on, their accountabilities are redesigned and they pick up and drop functions. The practical experience they accumulate feeds into the policy-making and evaluation process and may be influential in changing policies. The designers of new entities need to consider what the possible paths of development of a new entity may be and account for that in the way it is established and in the incentives that are set around it.

The Crown entities that are involved in the delivery of policy should be engaged in the network of strategy development to help focus their efforts on key priorities and to feed valuable information and evaluation into the central policy ring. Crown entities should also have clear strategic business plans that are the main instruments of engagement with the rest of government, and, in particular, the related ministries, about their role and

²²⁵ Brosnan, *Public Sector*, Vol (20), *op cit*, pp 6–9.

significance to broader government strategy. This engagement improves their organisational learning and strategic alignment over time.

Approaching the Crown entities from a perspective of system dynamics also brings a focus on the relationship between organisations and the way they interact over time. Once all entities have benchmarked their internal management and vertical accountabilities to best practice, the major arena for further improvement will be the development of these interactions. Evaluations of entities, therefore, need to be comprehensive and account for these dynamics and relationships.

CONCLUSIONS

Much effort over ten years has gone into piecemeal development of the framework of management and accountability for Crown entities, but there are still unjustified peculiarities and holes in some areas. A renewed effort is needed to get a comprehensive approach in place and to raise the standards of accountability and governance.

While there are many improvements that can be made to 'housekeeping', Crown entities will not respond to a shallow approach to review. A structured and prioritised work plan is needed to consider the policy analysis underlying the entities in their own domains. The renewal cannot be driven by an approach that focuses only on the entities themselves instead of the policies that they are intended to implement.

The challenge for government is twofold in improving the performance of Crown entities. The first is to clarify the government's policy objectives within a framework that can be used as a base for institutional design. Secondly, the public sector reform model needs to be extended to develop more fully the institutional forms and accountability arrangements that can deliver the objectives sought and perform the required functions.

In the past there has sometimes been inadequate consideration of the interests of the government and other parties in detail. As a result, a number of organisations have been set up as commercial organisations with minor constraints, when the reality is that the ministers are accountable for the day-to-day detail and have political and policy objectives that place Crown entity boards in a position of conflict with their duties as directors under company law. If the interests of the parties are thought through carefully from the beginning then the design of governance and accountability arrangements and the choice of the legal form of organisation can be made more soundly.

Crown entities should be planned and managed with an eye to the dynamic influences on them that govern their evolution. Incentive and

accountability arrangements can have major influences on whether a particular entity gets better or worse over a few years of evolution.

The 1999 Crown entity initiative provides an impetus to move forward the management principles and practices of Crown entities. It should avoid being too focused on tightening controls and authorising routine ministerial intervention in management and should take measures that will promote greater effectiveness and efficiency in the medium term. Over time, the policy frameworks surrounding most entities need to be reviewed and strengthened.

APPENDIX A: LIST OF CROWN ENTITIES 1999

Crown Entities

Accident Rehabilitation and Compensation Insurance Corporation	New Zealand Antarctic Institute
Accounting Standards Review Board	New Zealand Artificial Limb Board
Agriculture and Marketing Research and Development Trust	New Zealand Business Development Board
Alcoholic Liquor Advisory Council	New Zealand Film Commission
Animal Control Products Limited	New Zealand Fire Service Commission
Asia 2000 Foundation of New Zealand	New Zealand Fish and Game Council
Broadcasting Commission	New Zealand Game Bird Habitat Trust Board
Broadcasting Standards Authority	New Zealand Government Property Corporation
Building Industry Authority	New Zealand Law Commission
Careers Service	New Zealand Lotteries Commission
Casino Control Authority	New Zealand Lottery Grants Board
Civil Aviation Authority of New Zealand	New Zealand Qualifications Authority
Commerce Commission	New Zealand Sports Drug Agency
Commissioner for Children	New Zealand Symphony Orchestra Limited
Creative New Zealand	New Zealand Tourism Board
Crown research institutes (9)	New Zealand Trade Development Board
Early Childhood Development Unit	Office of Film and Literature Classification
Earthquake Commission	Pacific Islands Employment Development Board
Education and Training Support Agency	Police Complaints Authority
Electoral Commission	Privacy Commissioner
Environmental Risk Management Authority	Quotable Value New Zealand Limited
Fish and game councils (13)	Race Relations Conciliator
Foundation for Research, Science and Technology	Radio New Zealand Limited
Government Property Service	Reserve Bank of New Zealand Limited
Health and Disability Commissioner	Reserve Boards (54)
Health Funding Authority	Residual Health Management Unit
Health Research Council of New Zealand	Retirement Commissioner
Health Sponsorship Council	Road Safety Trust
Hillary Commission for Sport, Fitness and Leisure	School boards of trustees (2,664)
Hospital and health services (22 hospitals, 1 blood service)	Securities Commission
Housing Corporation of New Zealand	Special Education Service
Housing New Zealand Limited	Standards Council
Human Rights Commission	Takeovers Panel
Land Transport Safety Authority of New Zealand	Te Reo Whakapuaki Irirangi (Te Mangai Paho)
Learning Media Limited	Te Taura Whiri I Te Reo Maori (Maori Language Commission)
Legal Services Board	Teacher Registration Board
Management Development Centre Trust	Tertiary education institutions (39)
Maritime Safety Authority of New Zealand	Testing Laboratory Registration Council
Mental Health Commission	Transfund New Zealand
Museum of New Zealand Te Papa Tongarewa	Transit New Zealand
	Transport Accident Investigation Commission
	Trustees of the National Library

APPENDIX B: TEN YEARS OF DEVELOPMENTS IN THE CROWN ENTITY FRAMEWORK

The Finance and Expenditure Committee received numerous submissions on the Public Finance Bill 1989 that were critical of the definition and the list of entities in the schedule.²²⁶ It expressed concern that this area of the Bill was incomplete while acknowledging that it did not come into force until July 1991. The committee supported the contention of the auditor-general that criteria for inclusion of Crown agencies should be in the Act, but it saw the development of those criteria as being complex and time consuming because the boundary between Crown agencies and private organisations would need to be determined. The committee proposed a definition that was incorporated into the Act as follows:

... any entity over which the Crown is able to exercise control as a result of:

- its ownership of the majority of the shares of the entity; or
- its power to appoint a majority of the members of the governing board of the entity; or
- significant financial interdependence;
- but does not include a department, an office of Parliament, or a State Enterprise listed in the First Schedule to the State-Owned Enterprises Act 1986.

This provided an all-embracing definition and would have imposed new reporting requirements on all entities large and small. The government considered it would be unwise to attempt to resolve all these issues by 1991 and the implementation of the provision of the Act regarding the Crown entities was further delayed by the Public Finance Amendment Act 1991.

In 1992, a further Bill to amend the 1989 Public Finance Act was introduced and referred to the Finance and Expenditure Committee. The report of the committee recommended changing the name from Crown agencies to Crown entities to avoid inclusion of organisations from which the Crown 'makes substantial purchases of goods and services but which are not owned by the Crown'.²²⁷

²²⁶ Report of the Finance and Expenditure Committee 1989, report on the Public Finance Bill 1989, New Zealand House of Representatives, first session, 42nd Parliament.

²²⁷ Report of the Finance and Expenditure Committee 1991 on the Inquiry into Reporting by the Crown and its Sub-entities to the House of Representatives, New Zealand House of Representatives, second session, 43rd Parliament.

The committee recommended that 'Crown entity' should be defined primarily by reference to inclusion in the schedule to the Act but described tests that should be used to determine whether an entity is owned by the Crown. It stated that:

Crown entities are those bodies corporate other than SOEs:

- in which the Crown owns a majority of the voting shares; or
- for which the Crown has the power to dismiss a majority of members of the governing body or, where no such body exists, has the power to dismiss the chief executive, and replace the governing body or the chief executive with a governing body or chief executive which is primarily responsible to the Crown; or
- for which the Crown has the right to more than fifty percent of their net assets on their disestablishment; or
- in respect of which the Crown would be expected to assume any residual liabilities other than pursuant to a guarantee; or
- which Parliament considers to be owned by the Crown and deems to be Crown-owned entities.

Accordingly the Act was passed in 1992 with the following definition of Crown entities:

... a body or statutory officer named or described in the Fourth Schedule to this Act; and

- where a body named or described in the Fourth Schedule to this Act is a company, includes any subsidiary of that body; and
- where a body or statutory officer or trust named or described in the Fourth Schedule to this Act is a member of a company that would, if that body or statutory officer or trust were a company, be a subsidiary of that body or statutory officer or trust, includes that company and every subsidiary of that company.

The effect of this amendment did not change the underlying principles of the 1989 Public Finance Act, but it dealt with the ambiguous status of some entities in respect of Crown ownership by removing automatic inclusion on the basis of general principles and by requiring a government decision to include each one in the schedule. While this was a sensible pragmatic response to the situation at the time, it would be desirable to return to a statement of principles that apply automatically, once a review of all existing entities has been completed over time. Otherwise the possibility exists that some organisation is not on the schedule but has liabilities that are effectively resting with the Crown.

The 1992 amendment to the Public Finance Act 1989 changed the reporting and accountability requirements of Crown entities from straight financial reporting to include specific financial reporting requirements for specific classes of entities. It made provision for the appropriation of surpluses to go back to the Crown and, most importantly, the requirement for a 'statement of intent'.

A further amendment in 1994 established that a subsidiary controlled by a Crown entity is itself a Crown entity.

The statutory formalities were finally settled but there was no analysis to determine whether these organisations should exist individually or whether they would be better as SOEs or departments.

Since that time, relationships between Crown entities and the Crown have evolved in a piecemeal and unsatisfactory way. There are a variety of different approaches to formal and informal frameworks of accountability and responsiveness to the government. Issues also remain over the proper application of GAAP.

Crown entities are brought into the government's financial statements on the equity approach to consolidation. This only records the value of the Crown's investment in the entity. In private sector accounting this procedure is employed when the owner is a passive investor in the entity. However, when there is substantial control exercised by the owner, the proper treatment is full consolidation of the accounts of the entity into the accounts of the owner. State-owned enterprises were entered on an equity basis because at the that time the first consolidated accounts were prepared in 1992 the government had been for some years at pains to establish with the markets that it did not stand behind the debts of the enterprises. This provision has been formally established for the Crown entities also but is scarcely credible for entities that are monopoly suppliers of vital public services, particularly when they obtain funds from the government's budget and are controlled by elaborate accountability systems leading back to ministers. The substance of the relationship between Crown entities and the government is very close and it is likely that full consolidation will be required in the future.

STRATEGIC MANAGEMENT FOR THE WHOLE OF GOVERNMENT

INTRODUCTION

How can the government as a whole, across all its disparate organisations, act promptly and purposefully to seize opportunity and respond to changing environments? How can it identify and manage large-scale risks? This chapter discusses concepts and processes that have been partially developed in recent years for improving the strategic management of government. It comments on the historical and current management situation and makes suggestions for improvements.

The chapter incorporates some general concepts of 'strategic management'. It also accounts for the realities of governments in general and the particular practices of the New Zealand government in recent times. Consideration is given to the integration within individual organisations of policy analysis and evaluation, decision-making processes, performance requirements, implementation, incentives and culture. The concept of 'strategic alignment' is used to encapsulate this. The chapter discusses how the public management systems and culture can be brought together with evolving but stable and coherent policy frameworks to drive up performance across the government over time.

STRATEGIC MANAGEMENT

The concepts and practices of strategic management appear in an extensive literature that is focused mostly, but not exclusively, on private sector corporations. Much of this is relevant to the public sector at the level of an organisation, but is less relevant to the whole of government where the institutions and practices are very different from a private corporation. At the least, the concepts and practices need modification to account for the fact that the objectives, incentives, accountabilities and skills required for the strategic management of a government are very different from those in a private corporation. A cabinet is not a board of directors, a prime minister is neither chair nor chief executive; they are not there to maximise shareholder wealth except in some larger philosophical sense. No company would attempt to deal with the spread of functions that governments do.

The basic idea of a strategy for a government should be defined differently from private sector corporate strategy to account for the differences. Johnson and Scholes define strategy as:

... the direction and scope of an organisation over the long term, which achieves advantage for the organisation through its configuration of resources within a changing environment, to meet the needs of markets and to fulfil stakeholder expectations.²²⁸

For a government, strategy might be described as its direction and scope over the long term, which assists it to raise the welfare of the citizens by configuring activities and resources to meet their expectations. This would involve concerns for the role of government, efficiency, effectiveness, good governance, transparency, accountability and participation of citizens.

The general description of the processes should be, and mostly is, similar between the two sectors. The differences lie in the specific details and processes of strategic management but the basic scheme is the same. This involves:

- strategic analysis;
- strategic choice; and
- the implementation of strategy.

Johnson and Scholes describe the basis for strategic analysis as the:

... consideration of the environment, strategic capability, the expectations and the purposes within the cultural and political framework of the organisation.

Strategic analysis by governments could also fit within this description.

Strategic choice in the private corporation rests on the bases for choice, which are found in its mission, its ownership expectations, its sources of competitive advantage, its generic strategies, markets and other factors. A government has very different bases for strategic choice stemming from the democratic processes, the advice of officials and others, its manifestos and ideology and its political strategy for sustaining the support of various constituencies.

Implementation of strategy involves, in both sectors, the translation of strategy into action through attention to structures and systems or the 'strategic architecture', allocation and control of resources and the management of change. As Johnson and Scholes observe,²²⁹ strategic

²²⁸ Gerry Johnson and Kevan Scholes, *Exploring Corporate Strategy*, 4th edn, Prentice Hall, United Kingdom, 1997, p 10.

²²⁹ Johnson and Scholes, *op cit*, p 16.

management influences operational management but is different from it in several characteristics. Strategic management is ambiguous, complex, organisation wide, fundamental and long term. It commonly involves a repositioning of an organisation within its environment. Implementing this requires transformational changes that often stress an organisation and push it outside its comfort zones. Operational management by comparison is routine, specific and short term.

In public and private sectors alike, strategic management happens in layers from the organisation-wide level to the operational units. For the organisation as a whole to be well managed strategically, the interactions between the layers must be open and rich in information.

Hierarchical concepts influenced management 20 years ago, in both the public and private sectors. Planning was a central function and operating managers basically took orders from above. A typical depiction of public management back then can be seen in Figure 11.1 below. This management cycle is often found in government publications and appeared, for example, in publications on financial management by the United States General Accounting Office in the 1980s.

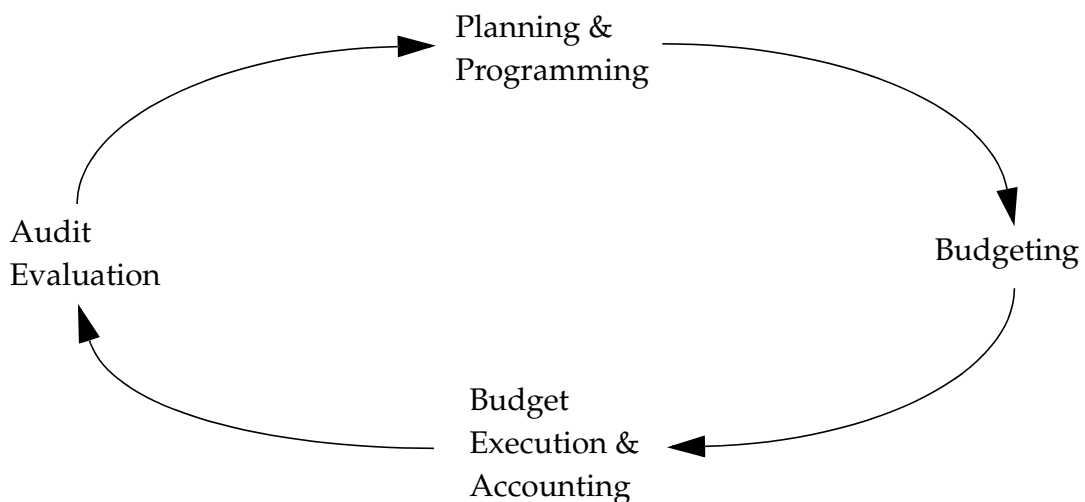


FIGURE 11.1: The financial management process

The underlying philosophy of this process is that the centre of government can effectively marshal all the information needed to lay plans and budgets that will be implemented, as intended, by the administrative agencies of the government. Audit and evaluation processes, together with updated central plans, will provide the centre with the information needed to set the whole system on a recurring annual cycle. The government is viewed as being

similar in terms of management to a large corporation with a large central office and numerous operating divisions.

Practitioners and academics today view the management of successful large and complex organisations as less centralised and as based on different principles. The contemporary view of how to achieve efficiency and effectiveness in a large organisation is to have the processes of strategic thinking occurring at all levels. Large organisations now operate in rapidly changing and complex environments that undermine the ability of the executive management centre to make well-informed decisions and implement them rapidly. The management centre can become a bottleneck for decision making throughout the organisation. Expanding the centre to deal with this does not overcome the problem of poor decision making that arises from so-called 'bounded rationality'. This involves rational decisions on the basis of inadequate information. Important information lies far from the centre of government. A management system that allocates power to make real decisions to operating managers and those in contact with customers is likely to reduce the problem of bounded rationality. By the same token, staff and managers in dispersed operating divisions are not well placed to see the organisation-wide picture and are not able to react to events that are outside the capabilities of their businesses. They, too, would suffer from bounded rationality if they were to try to react to organisation-wide issues in isolation.

Traditional centrally managed corporations often lack incentives for, and the culture of, promoting the achievement of organisation-wide objectives. This creates agency costs. Incentives, information, organisation-wide strategic thinking and a supportive culture have proven their superiority as a force over command and control in reducing those costs. There should be patterns of alignment in the goals, motivations and actions of all levels that are consistent with the achievement of the organisation-wide objectives.

For these reasons the effort to transform bureaucratic organisational cultures in both public and private sectors over many years has been aimed at placing power much closer to those in contact with customers and with production processes. Control is maintained at the management centre over strategic direction, key external accountabilities, values and culture. While the centre must take responsibility for protecting these hard and soft elements of cohesion and control in the organisation, the processes for determining what they are must involve people across the organisation, if they are to be soundly developed and motivating to those at the coal-face.

For this to succeed, there needs to be vigorous and open communication, both vertical and lateral, and less hierarchical decision making about details.

In contrast to the simple management cycle in Figure 11.1 above, Figure 11.2 below shows how central and operational functions should relate in a complex organisation. The main headings, like those in the previous diagram, concern planning, execution and review, which is changed to include adaptation, but there the similarity ends. The elements noted under the headings suggest the specialised roles and main influences around the three functions. The arrows represent information flows and interactions between parties within established roles and processes of management and decision making. The responsiveness of each main function to unpredictable influences captures the notion that the system as a whole adapts to change in a diffused way, rather than through the centralised co-ordination of relatively 'dumb' operational units.

The emphasis on information flows that pass in all directions symbolises the underlying characteristics of a strategic or purposeful management network.

In summary, strategic management is about promoting direction, purpose and transformation from the management centre, while preserving the devolved management that is essential for quality and innovation in service delivery and also creativity in policy analysis. This requires a balance of central and local management initiative and control that is hard to achieve especially in a highly complex organisation like a government. With too much central control of policy and operations, the management centre of an organisation will take unnecessary risks and make huge mistakes because of gaps and distortions in information and incentives that do not always align well with the wider public interest or the longer term. Too little central direction and leadership through the lower level units in an organisation, even if well managed, will leave opportunities unrecognised and will fail to deal with organisation-wide problems. Decentralised planning and management allows organisations and their staff to respond well to changing requirements and to anticipate and create new directions within their subsidiary mandates. They need to be guided in coherent and consistent directions by high-level policies and plans.

Formal and informal processes are needed in order to get both the hard and soft sides of management entwined in successful strategic management. Transformational change usually requires strong organisational culture, values, and emphasis on communication and leadership.

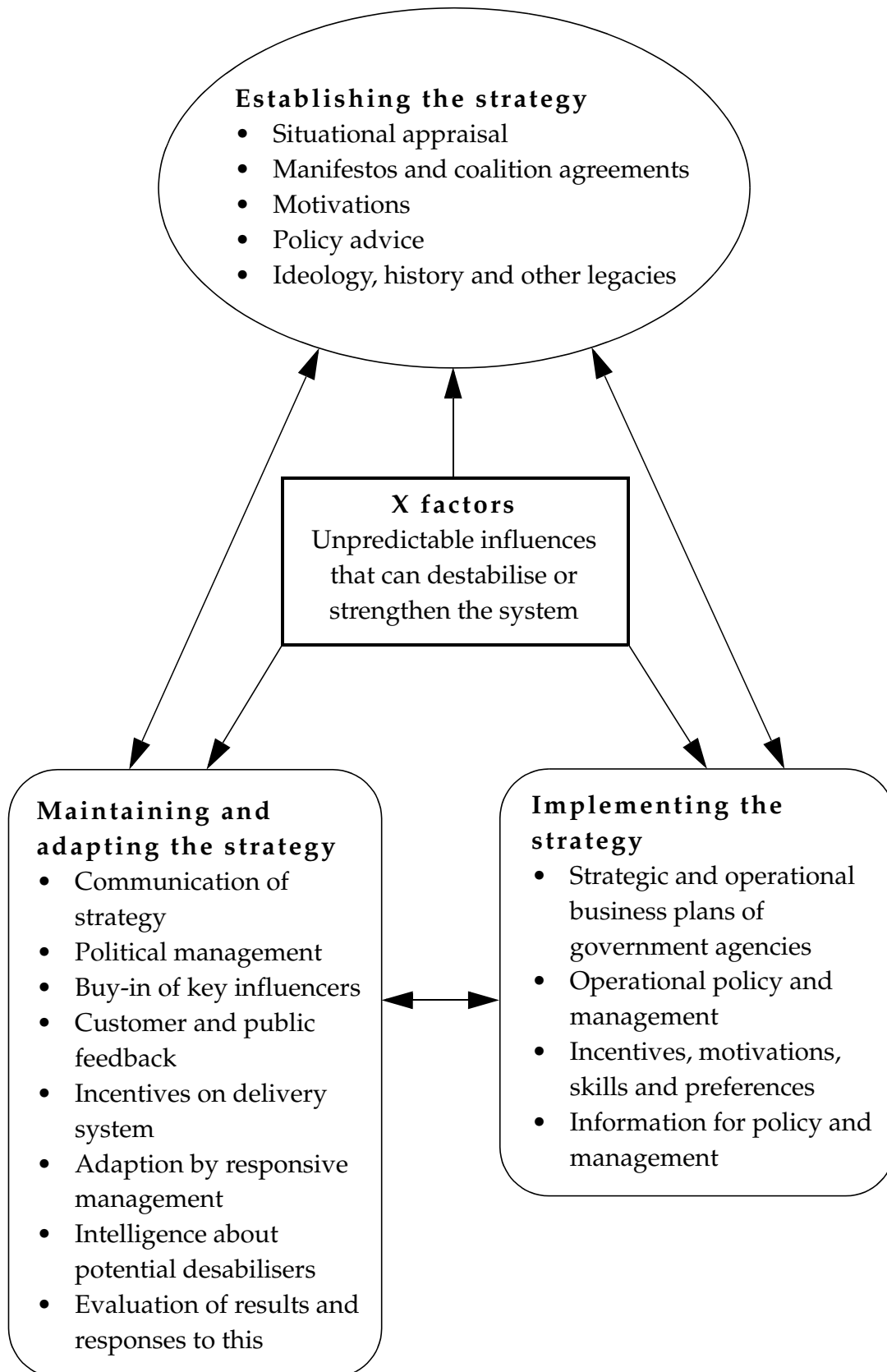


FIGURE 11.2: Strategy in action

Strategic alignment

Bringing all these aspects of management together is how complex organisations become proactive in response to opportunities and threats in their environment and bootstrap their performance through adaptive learning. Such organisations can be described as having 'strategic alignment', which lifts their performance beyond best practice benchmarking of its individual management systems on to a path of dynamic performance improvement.

Strategic alignment within an organisation is evident when its capabilities, decision making, configuration of resources, management information, incentives, behaviours of staff, organisational values and culture are all compatible and supportive of the achievement of the organisation's strategic objectives and its mission. Achieving strategic alignment requires units within the organisation to plan and manage within the envelope of strategic thinking and of decisions already being developed for the organisation as a whole by higher levels of management. Operational priorities, the allocation of resources, and investments in capacity development should all reflect and support the overall strategic direction.

Strategic alignment demands both an external and internal orientation. The key drivers of thinking, planning and behaviour are what the broader organisation wants and needs and not the internal preferences and habits of the managers and staff. The purpose and value of work to those whom the organisation serves are emphasised along with the technical standards that are required. Benefits to customers and the public become the goals in developing and meeting new product and service specifications. Open communication with customers and business partners, and efforts to understand their points of view, become the norm. This pattern of behaviour is not nearly common enough in government.

Strategic alignment demands a focus on the future. What must happen today may well be urgent, but what could happen tomorrow could be critical. The resources and activities needed to implement plans for the future are protected from being diverted to current production or are cut back to meet short-term budget constraints. In practice this shows that the management has the ability to implement tough decisions about current priorities to release resources for investments for future priorities. New ideas, technological development and environmental change are all actively reviewed to check for development opportunities. The culture has no problems in accepting challenges to current thinking or even to the strategy itself. Suggestions emerge spontaneously, and innovative thinking becomes a routine part of the organisational activity.

When achieved, strategic alignment reduces the need for higher level managerial decision making in respect of lower levels of management. Devolution increases without loss of strategic control from the management centre. Local managers can clearly distinguish the choices that contribute to achieving the organisation's strategic vision from those choices that do not. Actions are taken accordingly, without discussion or reference to higher authority. Less 'fuss' is apparent, because those closest to the decisions deal with them directly. The need declines for committee meetings and management troubleshooting. Genuinely ambiguous and complex issues are rapidly recognised and presented for resolution, and not put in the 'too hard' basket.

Strategic alignment demands collaboration. Units and individuals are keen to communicate and co-operate with anyone who shares their strategic objectives and can contribute to achieving them. Organisational boundaries become more permeable and fluid. Cross-functional and cross-organisational teams become a common way of working. Joint problem solving replaces a win-lose approach in negotiation both inside the organisation and with suppliers and customers. Matrix management becomes feasible, because it does not overload top management with disputes to resolve because they are being resolved at lower levels.

If alignment is achieved, synergy will follow because the activities of each unit, and their innovations, will reinforce those of other units. The organisation begins to improve itself spontaneously and organically like the adaptations of a multi-celled living organism. Information, ideas and proposals flow up and across the whole organisation and not only from the top down. The organisation operates as a network and the management centre does not block the activities of the operating units but rather gives them strategic directions, resources and alignment across the organisation.

What are some indicators of process and culture within an organisation that is being strategically effective? They include:

- the vision for the future is compelling and motivating;
- strategies for the future are based in thorough analysis and practical considerations;
- there is organisational consensus on change opportunities and directions for change;
- where justified, substantial shifts in priorities and resources emerge;
- opportunities for high-quality re-investment in resources are identified;
- routine management processes are relevant and well informed;

- stakeholders endorse and support the strategic direction;
- strategic processes support and integrate with other management processes;
- there is clarity as to whether the organisation is on or off target;
- managers use all their systems and budgets creatively and consistently to implement change; and
- the strategy is embedded in the budget processes and feedback and evaluation activities.

The sense of purpose that strategic alignment provides can be unconscious. Many organisations that have it do not see it as particularly remarkable, unless they remember the times when it was missing. In smaller organisations, the planning processes feel informal and natural and the distinction between planning and operational issues dissolves. However unconscious it becomes, its effects are evident. People who know 'why they are there' derive greater satisfaction from their work, and they are rarely cynical about it. Strong commitment to the job is a cultural norm, not a trait deserving great notice or reward. People abandon power games and distorting information aimed at enhancing their position at the expense of the organisation's performance.

An absence of strategic alignment can be recognised by the opposite characteristics to those above, together with:

- an internal focus on rules and procedures;
- conservatism about changing things;
- uncertainty about who has authority to make decisions and frequent referral upstairs;
- territorialism and patch protection, unwillingness to share information, to co-operate or to accept peer review;
- detachment, resignation and blame-shifting about inadequacies in performance; and
- refusal to take responsibility for results.

The indicators of strategic alignment and effectiveness in an organisation can be seen to overlap with other dimensions of management performance. Strategic management is not about some unique process of management that is separate from the rest. Strategic competence is not going to arise in an organisation that is badly managed and, in fact, good management begets good strategic thinking. Strategic alignment is no more than an expression to describe the culture and processes of an organisation that is well managed in

terms of the basics and that has reached beyond that to become dynamically effective. The organisation has become an empowering environment for people who are free to use their creative energies, and who are motivated to do so, in the interests of well-articulated organisational purposes and strategic goals.

An organisation that has strategic alignment has an external orientation and a concern for thorough strategic analysis, which is generally immunised from major errors in strategic thinking. But errors are always a possibility.

A particular risk for public organisations is that they set themselves goals different from those from which their customers, the government or the public, would most benefit. A monopolist may seek to preserve its monopoly and direct its energies accordingly. A bureaucracy may put preservation of its territory and decision rights ahead of other goals. New Zealand's public and private sectors have plenty of examples where an organisation, protected from competition or sanction, appears to be aligned to self-selected goals. Its various parts seem to co-operate instinctively to resist change and external threats. In the early stages of any debate over emerging issues, policy discussion is always inconclusive and an organisation in an entrenched position only has to 'play a dead bat' to protect its position.

Changing alignment is difficult, so high quality strategic thinking should precede alignment efforts. External stakeholders of public organisations must remain alert to the possibility of insular organisational thinking and unexamined internal preferences prevailing and should ensure that external concerns and the wider public interest shape strategy.

In the government environment, strategic alignment within and across all the component organisations will always be incomplete because no government has a systematic and coherent view across all policy areas. Government can, however, have such a view across the main priorities on its agenda. Gaining alignment across the constitutional divide between politicians and professional managers and advisers is a challenge that is peculiar to governments. The remainder of this chapter addresses some of the main issues and examines the systems that have evolved.

STRATEGIC ALIGNMENT AND POLICY COHERENCE: THE CASE OF THE INLAND REVENUE DEPARTMENT

This discussion of strategic alignment is necessarily only a thumbnail sketch. I have never seen a public sector organisation with all the characteristics of strategic alignment as listed above. I have, however, seen some that have

most or all of the indicators of an absence of alignment. There have been numerous public hospitals in which the management has struggled to get to the level of basic managerial competence and has stayed far short of the excellence that strong strategic alignment can bring.

In the 1970s a good proportion of public service departments and ministries could have been reasonably accurately described as having some or all of the characteristics listed above, indicating an absence of strategic alignment. The past 12 years have seen a lot of improvement in this regard and there are a few examples of strong strategic competence although, as Schick noted, there are departments that are adrift and bereft of purpose.

Even the generally very well managed organisations can have difficulties in alignment from time to time. There is not much in the public record that can be used to illustrate the point. One recent example is, however, available and that is the Inland Revenue Department (IRD).

The IRD has for many years been a well-managed organisation which has, particularly in recent years, undertaken profound changes in the way in which it operates the tax collection system. It has done this without much fanfare. It is an organisation that has been subject to an enormous amount of criticism in recent years, much of which is unfair and some of it, which arose in the winebox inquiry, scurrilous. It has always been led by people with the highest integrity.

It is with this background of generally high quality management and strategic capability in mind that it is of interest to consider the inquiry by the Finance and Expenditure Committee in 1999 in relation to the question of strategic alignment.²³⁰ The inquiry focused on whether the department was being heavy-handed in the approach to taxpayers who were in arrears with their payments. The inquiry gained a head of steam as a result of allegations that particular individuals may have committed suicide because of their businesses being bankrupted by IRD's pursuit of outstanding tax obligations.

Strangely, the substantive sections of the report focused on detailed technicalities in the administration of the tax law that were significant, but not dramatic, in the context of the total administration of tax law. The report did not really get to grips with the management issues that gave rise to the inquiry. As the commissioner said in his response, half of the

²³⁰ Report of the Finance and Expenditure Committee, *Inquiry into the Powers and Operations of the Inland Revenue Department*, New Zealand House of Representatives, 1999.

recommendations in the report would require a change in the law. However, the IRD has great influence over the detailed drafting of the law and so it has a share of the responsibility if the reason for inappropriate behaviour with taxpayers is in the law.

The report reviewed policies and practices of penalties, debt collection, handling complaints, write-offs and bankruptcies. Its recommendations on these technical topics were generally in technical terms and did not directly address issues of process and culture. There are points, however, where it did. It made a recommendation that the identity of any officer accessing a taxpayer's file be recorded electronically. Also the department was praised for its efforts to improve its telephone services.

In regard to aspects of organisational culture that bear on strategic competence, the select committee came down quite hard on the need for a change in culture in the IRD. It referred to:

... a culture of punishment and fear which impacts upon both staff and in turn taxpayers. Irrespective of the extent to which this is true we believe that there must be a cultural shift within the department and that shift must come from the top ... the pendulum has swung too far towards the use of sanctions and threats to enforce compliance. Taxpayer satisfaction must become paramount for the department ... What we consider is required is an attitudinal shift. This shift needs to come from senior management and involve a restatement of values focusing on the needs of the department's customers.²³¹

The report gave space to the view of the PSA that there may be undue pressure on staff to meet unrealistic or inappropriate performance targets. The report, however, provided no substantiation of this.

If it were true that staff performance targets were inappropriate, then this could cause serious distortions and a clash between the high-level values that top management was trying to inculcate and the actual behaviour of staff. Statements of organisational values are worthless if the management does not do the work needed to ensure that they are reflected in the organisation's detailed performance goals, processes and decision rules. Management will likely fail at this if there are strategic influences imposed on them that they cannot control.

On this point it seems to me that the IRD has been the implementer of a tax strategy that arguably indicates a problem in fiscal strategy. Since the mid-1980s to 1999, ministers of finance have had strong views against raising tax rates. They have been very concerned about the distortionary effects on

²³¹ Report of the Finance and Expenditure Committee, *op cit*, pp 50 and 51.

the decisions of businesses and households of high marginal rates of taxation. Ministers have preferred to extend the tax base to which the tax rates apply and to keep the rates low. But for much of the period in question, the fiscal stance of the government has been unsatisfactory and, at times, in crisis as in 1990. Some of the attempts to extend the tax base ran into political problems as in the extension of fringe benefit taxes in the early years of the Bolger administration. Other possible extensions to the tax base were ruled out as with capital gains tax.

The consequence has been pressure to extend the tax base to the limits through administrative means. Governments have also repeatedly taken the one-off benefit to a particular budget of bringing forward the timing of the receipt of various tax revenues through administrative means. This has been a key element in the strategic direction of the IRD and it must surely have had an impact on the business processes and culture.

A further strategic influence that I suspect has been at work is the government-wide squeeze on investments in capability discussed in chapter eight. The tax system has always relied on honest self-assessment by taxpayers backed by routine checks and targeted investigations. Having tough penalty regimes and high interest charges on delayed payments is surely seen by policy makers as increasing the incentives on taxpayers to be accurate and timely in their payments and, thus, lowering the department's costs of collecting a given amount of tax. But the side effect of this will be to make the department seem officious and hostile to taxpayers with problems.

In reference to a key overriding performance objective, the committee's report emphasises the principle of collecting the highest net revenue over time and not the collection of revenue at any cost. The difference in terms of staff performance objectives between the two could be large.

These external strategic influences might be seen as sacrificing the reputation of the department with taxpayers in order to address fiscal problems. However, it seems that there are also internal strategic influences.

The commissioner accepted that there have been some areas of the department's service that have been below an acceptable standard, but that these are a tiny fraction of the department's total work. Also the IRD already had a set of commitments setting out the type of culture, working environment and standards that it was seeking to ensure. The review committee wanted more and, as a practical step, it recommended a taxpayers' charter, a template for which was drawn from similar charters in other tax jurisdictions.

There is an obvious gap between the select committee's view of IRD's customer service culture and that of the department. While the select

committee's report is not definitive in its view, it gives a prominent mention to critical submissions in its report as follows:

Many submitters to the inquiry had genuine and deeply-held grievances with the way they have been treated by the department. Several made appearances before us at considerable cost. We greatly appreciate their input. Our thanks go to them.

The whole episode illustrates just how hard it is for a major public organisation, with a very difficult job to do, to get its alignment just right. The IRD walks a fine line between administering laws that require it to be fair but vigorous in ensuring that people meet their tax obligations, while, at the same time, it is vulnerable to the accusation that it is being too vigorous in this regard. It is expected to outwit the best and the brightest in the global tax avoidance industry. It is also expected to be reasonable with small domestic businesses that get in a muddle with their taxes. Getting an organisational culture in place that fits these requirements is a lot to ask. It appears, however, that IRD still has some work to do to get such a culture spread uniformly throughout the department. The select committee is right to say that the responsibility for this rests with top management.

It would be very easy for the IRD to lapse into processes and a culture amounting to poor strategic alignment. Specifically, the necessity for it to be highly bound by rules and procedures and secretive with information in its work with taxpayers could spill over into other aspects of its organisational culture and create conservatism and a lack of trust internally where innovation and co-operation is needed. Because people do not like paying taxes, and some cheat, the tone of communications with taxpayers could easily become officious and inappropriately mistrustful. The IRD is necessarily a secretive and technical organisation in many respects. This is a difficult environment in which to breed the values necessary for excellence in managing people and in serving customers.

If the top management has not already done so, it should carefully review all the business processes to ensure that they reflect specific organisational values in a practical way. This is not easy and in my experience this work is never complete.

STRATEGIC THINKING IN GOVERNMENT

The sense of purpose of a government comes from the mandate it perceives it has from the voters who put it in office. But if that mandate is not internally consistent and achievable, then the government will be in difficulty from the time of its first budget. The strategy of a government goes beyond specific

policy promises and is also rooted in its political ideology and the values, principles, history and culture of society.

Governments easily get out of tune with the voters and sections of the public. This happens because of the inner dynamics of governments and political parties and the personalities and policy preferences of powerful individuals. It can also happen because of poor policy analysis and information flows in and around the government. It has been happening over recent decades because of unrealistic expectations created in the heat of election campaigns and because of turbulence in the economy. Further, it is often very difficult to know what the preferences of voters actually are. Pressure groups can hijack policies for their own interests especially when it is not clear where the wider public interest lies, because it is diffused, silent or badly analysed by policy advisers. It is little wonder that most governments eventually lose their way and usually bring energy and coherence only to fragments of the whole tapestry they are finally accountable for. They keep trying different things to maintain voter support but, in the end, they all lose an election. As Hon Bill English, senior minister in the defeated National government in 1999 commented, when you have been in government a long time you have closed a lot of doors.

It follows that a strategy driven by government must have deep roots in policy analysis, politics and culture if it is to be motivating to people and capable of sustained implementation.

Policy coherence

Governments can have great difficulty in achieving coherence in their policy, planning and operational activities. This is due in part to the extensive role governments take on for themselves, the complexity of the functions governments choose to undertake, together with the expectations created by the political process. A government should not assume that doing something badly is better than not doing it at all or that market failure automatically means that government should act. Government failure can be worse. However, the political pressures to respond to every problem that comes along are considerable and often irresistible, even if a government does not have a coherent and well thought out plan to address a problem.

Coherence has more than one definition in government. What is incoherent in terms of principled and thorough policy analysis and implementation may be coherent in political terms, at least for a while. Over the long term, however, incoherent policy will destabilise even the most

stable political regimes, as the communist countries and, recently, many Asian countries found out.

A degree of incoherence in policy terms is inherent in democratic government. The internal checks and balances, contradictory manifesto promises, personalities, passions and competing power bases can easily produce inconsistent priorities and conflicting interventions. Ministers sometimes neutralise or distort each other's efforts while the bureaucracies sometimes protect their turf at the expense of the quality of policy. A clear eye for the longer term and the wider public interest can become clouded. It is not always easy to distinguish between the views of powerful interests influencing a government for the benefit of the wider public interest and those pushing only their own sectional interests. Even when key ministers see that incoherence has set in, they are often powerless to do much about it. MMP has made this a greater problem than before. The coalition health policy after the 1996 election, for example, was a fragile compromise between two fundamentally different policies and underlying philosophies that were bridged by words. The policy was referred to a group of advisers to develop a practical version that was capable of implementation.

Politicians are elected for their skills in politics not policy analysis, but New Zealand's political history is replete with skilful politicians whose careers were finally broken by incoherent policy formulation. Masters of the political process, ministers also need to master the skills of policy analysis and formulation, or at least how to organise others to do it for them. Short-term political judgements made in isolation from coherent medium-term policy frameworks are rarely a lasting formula for political success and never a formula for good policy. While a government's objectives and its agenda for change emerge from the political process and set the parameters and agenda of policy analysis, they are not a substitute for that analysis. The implications of policy proposals and the consistency between policies need to be thoroughly considered. As a result, the policy proposals may be modified. A durable policy framework must, nevertheless, rest on an equally durable political strategy.

Policy making in New Zealand has, at times, been incoherent. The basic criticism of the government's economic policies by the Treasury and the Reserve Bank of New Zealand in the early 1980s was that the policies were internally inconsistent and lacked strategic coherence. For example, in commenting on the wage and price freeze in its briefing to the incoming government in 1984, the Treasury said:

It is therefore fair to say that monetary, fiscal and exchange rate policies were all given as hostages to the freeze. A reduction in domestic inflation has been achieved at the cost of other objectives of economic policy. It is in this sense that our economic management has not displayed the essential balance seen in more successful countries.²³²

The same was true in 1990, as the split in the cabinet over policy directions caused erosion in fiscal policy and a serious imbalance with monetary policy, which contributed to the 1991 recession. The major energy projects of the early 1980s and constant churning of structures in the health sector are further examples.²³³ There have, however, been substantial areas of government policy that have exhibited strategic coherence over periods of time. Tax reforms over many years have rested on some fundamental principles. Closer economic relations with Australia has been a bi-partisan objective for 20 years. Policies on the General Agreement on Tariffs and Trade (GATT), the World Trade Organisation (WTO) and APEC are other examples.

Competition and co-operation between nations within an integrated world economy will favour those that are able to establish coherent medium-term policy strategies that are consistently implemented and continually adapted to the lessons of experience, rather than jerked about by economic and political cycles and shallow policy ideas.

Strategic policy must be of a standard that can be benchmarked against the best internationally, whatever the field. It is rarely easy to define and get agreement on the overarching goals of a major domain of policy and to express them in a manner that makes difficult choices explicit. New Zealand's track record in these things has been patchy. Poor analysis, undue influence of special interests, and professional capture have too often distorted important policies. Experience shows that it is hard to achieve economic policy settings that are consistent, credible and focused on the medium term, but it is an order of magnitude more difficult to ensure that government policy is coherent and consistent across the whole spectrum of its activities.

²³² The Treasury, *Economic Management*, 14 July, 1984, p 106.

²³³ I have discussed some issues in managing policy risk in the article "Managing Operational and Policy Risks at the Centre of Government" in *Risk and the Institutions of Government* edited by Alex Sundakov and John Yeabsley, Institute of Policy Studies and New Zealand Institute of Economic Research, Wellington, 1999, pp 14–34.

Policy advice

The government must be able to rely on strategic thinking of the highest calibre within the organisations of government, even though any government will draw on thinking beyond its own institutions. It is imperative that government organisations have the capability to think broadly and deeply about their future directions, and those of others they relate to, against a wider perspective on where the government is headed. They need to do this in a way that rests on professional analysis of the highest calibre and not 'whiteboard' exercises and strategic planning sessions, although these have a part to play. Held up against the benchmarks of world class strategic policy analysis, the record of strategic thinking in New Zealand's ministries and departments has been inadequate as a whole. No ministry or department reaches this standard all the time. Some meet it some of the time while some have never met it. The performance management system is simply too tolerant of the ministries and departments in the last group. Each ministry and department should take the steps necessary to ensure that it is capable of meeting high standards in this regard. What is required to do this will vary widely from ministry to ministry.

Processes for collecting and analysing information and reaching soundly based decisions must be well designed and entrenched by familiar usage. Information collection and policy analysis must be rigorous, relevant and insightful. Communication must be open and non-hierarchical and the whole process tied together by personal attitudes and organisational cultures to forgo the short-term and sectional interests in the longer-term interests of the performance of the government as a whole. An organisational culture is necessary that promotes good strategic thinking. This requires a chief executive, and a minister, who both value high quality thinking and are who comfortable participating in the process.

If good strategic thinking is to occur across the networks of government, as in the diagram presented earlier, then so must the supporting policy analysis as well. Detailed policies must be harmonised with larger policy frameworks. A useful distinction is commonly made between strategic and operational policy, or what is often quaintly called 'big P' and 'little p' policy. A decision to adjust a tax rate by 1 percent is a policy with a small 'p'. Whether it is a good or bad idea depends on how it fits with a wider framework of principles and government commitments about policy for the tax system as a whole, policy with a 'big P'. For the past 15 years ministers of finance have adhered to general principles of taxation that emphasise 'broad bases and low rates' and minimise distortions to the decisions of businesses,

consumers, savers and investors.²³⁴ A vast amount of detailed legislation and administration has been undertaken that sought to observe these general principles.

Another example of 'big P' policy analysis is the work that lay behind the Fiscal Responsibility Act 1994 and the subsequent annual cycles of work laying out the broad direction of the government's fiscal policy. The Reserve Bank of New Zealand Act 1989 and the Rt Hon Simon Upton's environmental policy strategy documents from the mid-1990s are other examples. Some strategic policy analysis applies to smaller issues than the policies addressed here but the characteristic of setting a general approach and principles based on sound analysis of the relevant system is present.

The development of broad and principled strategies and the work of translating them into practical frameworks of policy in particular circumstances are what is meant here by 'strategic policy analysis'. It is in this area where the cabinet can have a powerful influence on shaping the flow of detailed daily operational decision making. The development of broad principles provides the ministers with control over the total direction of their portfolios and the government as a whole. It facilitates the effective delegation of management authority to their departments and Crown entities.

For strategic policy to have such influence it must be integrated with, and have its foundations in, the regular flow of detailed policy and organisational operations. Otherwise, the grounding of strategy in the practicalities of the daily work of government is lost. Vital information and advice lies with customers and the people who are dealing with them, in addition to the information from more formal processes of analysis and considerations at the top levels of management. With processes of this kind, the strategic policy is not only more likely to be robust, but also more likely to be implemented, because the operational managers understand it and have the opportunity to make inputs.

However, some strategic policies do not involve complex information flows and delegated management, because the policy issues are fundamentally about the role of government at a high level. The creation of state-owned enterprises, tariff reform and the protection of statutory marketing authorities are examples.

²³⁴ The 1999 Labour/Alliance government has introduced a higher personal tax rate than the company tax rate, which is a movement away from this policy direction.

Difficult judgements have to be made on occasion in the development of strategy within ministries. It is the role of the chief executive to make these. Forward-looking advice that identifies risks and opportunities and seeks to promote change will always be controversial. Ministries and their chief executives will inevitably be heavily criticised by those who disagree with the advice. While such advice should be well crafted, carefully presented and wise in terms of the wider perspectives of the government at the time, it also needs to be forthright and, at times, fearless. If seemingly radical things need to be said with regard to economic policy, social policy, foreign relations or whatever, then it is the duty of senior civil servants to say them within the context of their constitutional relations with the government. It should not be acceptable, as has happened, for ministers to direct or imply that departments are not to provide strategic advice. Nor should a chief executive demur in such circumstances. On the other hand, ministers have the right to expect such advice to be based in sound analysis that would withstand peer review and not be just the personal opinions of the chief executive or merely an echo of what they perceive to be the minister's views.

Proposals to strengthen the strategic advisory capabilities of ministries and departments might be seen as encouraging centralism and as an unnecessary elitism in the development of policy. This could lead to excessive weight being given to the views of officials by comparison with those of politicians, political parties and the wider community. If this is a problem, it is best addressed through the political parties by strengthening their capacity for serious policy analysis which, I believe, they should feel obliged to do given that they have been accorded a quasi-constitutional status under MMP. Political parties should also be more open and disciplined in their policy development. The current government has strongly objected to officials questioning the policies that it developed in opposition and expects the officials to get on with implementing them. If, however, the policies had not been subjected to rigorous analysis elsewhere, then the government would be running needless risks. Whatever concerns there are about inadequacies in alternative flows of advice to politicians, it would be a mistake to try to balance up any weaknesses in the capacity of other sources of policy advice by deliberately weakening or tolerating weakness in the capacity of departments and ministries. Testing the quality of a government's policy proposals is part of the responsibilities of officials even though they must implement diligently whatever is ultimately decided.

The SSC and other central agencies need to be uncompromising in respect of the principle of free and frank advice. This is not to argue for relitigation of advice that has been rejected. A policy ministry should take a medium-

term view about the stream of advice it produces and work to ensure that its advice is not ultimately seen as incoherent fancy footwork. It should strive to create a coherent view that evolves as circumstances and analytical perspectives change but, by and large, stands the test of time.

It is very encouraging that, at a time when there has been pressure on the doctrine of free and frank advice, the state services commissioner, Michael Wintringham, has stated:

I am standing up for intellectual rigour, tough-minded policy formulation, free and frank advice, uncompromisingly good management and real accountability.²³⁵

A coherent and motivating government strategy is not going to emerge from a summit conference, a prime ministerial advisory committee, an economic planning model or a 'think-tank'. Rather, this strategy can only emerge through hard work within complex processes of politics, policy analysis, decision making and management. There are few short cuts. For a government to develop a coherent and dynamic policy and management programme, it should operate in accordance with the process illustrated in the diagram earlier. It needs to keep all the management cycles of its constituent organisations in synchronised motion and the feedback channels open and not distorted. The process should go much wider than the government itself and should engage with citizens who are affected by the policies at several levels through the layers in Figure 11.2, *Strategy in Action*.

There have been many attempts by governments to create processes of analysis, communications, broad participation and decision making on major issues for the country. In the 1960s, there was the National Development Conference that was replaced by the Planning Council and the Commission for the Future in the mid-1970s. This approach waned in the 1980s but may be revived. The 1999 Labour/Alliance government responded to heavy criticisms of their policies by business interests and falling confidence by organising a summit with selected business people. The prime minister's chief policy adviser, a political appointee in her office, has been charged with developing the next steps to follow this summit. The past 15 years have also seen the growth in the number of formal commissions and advisory bodies that have been charged with the development and monitoring of strategy in particular areas. The Royal Commission on Social

²³⁵ Michael Wintringham, state services commissioner, "Problems in practice: capability in the state sector", Legal Research Foundation conference, Wellington, 21 September, 2000.

Policy was a major attempt to bring a consistent body of thinking together on social issues. The Mental Health Commission is an example of one of these bodies. There have been various supporting consultative fora to which senior politicians refer issues for discussion, such as the Enterprise Council, which the Rt Hon Jim Bolger, as prime minister, used as a forum to discuss issues with the business sector. Requirements for public consultation have become formal and subject to public law. These bodies are set up for a variety of reasons including deflecting pressure from a government that does not really want advice on the area in question. Over the years governments have created an enormous number of ad hoc and standing advisory bodies with a wide range of results. It would be valuable for research to be done by the SSC, university researchers or others into the patterns of success or failure of these ad hoc bodies in order to distil lessons for the future.

Post-election briefings

Post-election briefings have been a significant vehicle for providing policy advice, but they may be declining in their significance. Before the Official Information Act 1982 and under the 'first-past-the-post' electoral system, preparation of post-election briefings provided the one opportunity for officials to develop their own views about policy, free from the pressure of daily interactions and policy preferences of their ministers. Post-election briefings were once secret documents. Prime minister Rob Muldoon refused his cabinet access to the briefing from the Treasury after the 1981 election. During the 1980s these briefings evolved in the expectation that they would be released under the Official Information Act 1982, or possibly even published by the government as has happened with the Treasury's briefings since the 1980s.

There have been questions asked about the use of post-election briefings in the MMP environment. As one official has put it to me, there is no point in providing strategic advice to a new minister who has just emerged from the negotiations to form a coalition with the ink still wet on the policies that have been agreed to. After two MMP elections, it is not clear what the pattern will settle into with regard to the level of specificity about policy commitments between coalition parties. The 1999 agreement is much less detailed than the 1996 one was. Even in 1996, one of the most contentious policies, the health policy, was passed to an advisory committee to interpret the agreement so that it could be practically implemented.

After the 1996 election there was an under-utilisation of the very substantial asset represented by post-election briefings from most, if not all, government departments. These documents were buried until after the

coalition was formed. It would have been far better to have made all these documents available to all political parties after the election as a background resource to benefit the coalition-forming process. Some procedure might have been developed to allow politicians to seek clarification and information about the post-election briefing documents along similar lines to the costing of various proposals completed, quite appropriately, by the Treasury during the post-election interregnum to assist the coalition negotiations. This concept should have been extended to include advice from the departments going beyond their post-election briefings. Careful control of the interaction by the heads of the public service would be necessary but feasible.

The days when the advice of departmental officials was highly secret are over. It is time to consider the release of vital information and the perspectives of the ministries on the major issues before the elections. The success of the pre-election fiscal updates required by the Fiscal Responsibility Act 1994 invites consideration of this proposal. Those updates are making a good contribution to political debate by making it harder for poorly prepared fiscal policies to be taken seriously. Evaluations by ministries of the situation and outlook in their policy areas might also raise the quality of public debate of the issues. Ministries have an obligation to ministers to do so, in addition to it being a discipline on them to be accountable to the public for the quality of their advice. I would agree with the concerns of the prime minister expressed after the 1999 election over departments using consultants to prepare their briefings if this is evidence of an inability to prepare comprehensive and well-analysed advice. Some of the briefings that were released after the 1999 election struck me as inadequate. I think that policy ministries should be expected to have well thought through and comprehensive advice and that this should be published in appropriate professional and general media. After all, the taxpayers have paid for it.

SETTING STRATEGIC GOALS

A key responsibility for any minister is to take great care in the setting of strategic goals for departments and Crown entities. This is still not often done well. A 1999 report by the auditor-general noted that government goals were 'generally high level and vague'.²³⁶

²³⁶ Controller and Auditor-General, *The Accountability of Executive Government to Parliament: Third Report for 1999*, Wellington, 1999.

Beginning in 1993, the Department of the Prime Minister and Cabinet (DPMC) (supported by the Treasury and the SSC) developed concepts of strategic result areas (SRAs) and key result areas (KRAs). The SRAs were statements about the government's medium-term high-priority objectives for a general area of policy activity. The SRAs belonged to the cabinet. The KRAs were key goals that government departments must meet in order to satisfy the requirement to make progress with the government's strategic goals. The KRAs belonged to the chief executives and were part of their performance specifications.

The first strategic cycle covered the years 1994 to 1997. The government developed a vision document from its political manifesto and other sources and published, in the name of the National Party, a document called *The Path to 2010*. These objectives were developed further in the document *Towards 2010 – Investing in our Future* which, unlike the previous document, was issued as a government document to accompany the budget policy statement in 1995.

In February 1995 the government published *Strategic Result Areas for the Public Sector 1994–1997*. This also accompanied the budget policy statement. Table 11.1 contains an extract from the prime minister's foreword to the document explaining its purpose in linking the government's strategic goals to the annual operations of departments.

TABLE 11.1: Extract from the Prime Minister's foreword

The Strategic Result Areas identify activities in the public sector that must be done – and done well – over the next 3–5 years to achieve the longer term strategy. These feed into “results” focused priorities within departmental budgets and work plans, and are part of the accountabilities set down in the performance agreements of departmental chief executives ...”

“... The Strategic Result Areas set out the contribution that the public sector will make to achieving the Government's strategic vision for New Zealand. They form the link between the Government's long term objectives and the operational activities of departments. They aim to bridge the gap between the broad vision of a future New Zealand as stated in the 1993 document *Path to 2010*, and the one-year focus of existing departmental budgets and chief executive performance agreements.

There were eight strategic result areas as listed in Table 11.2. In the official document there are a few paragraphs of detail amplifying what is intended under each of these.

TABLE 11.2: Eight strategic result areas

<p>Maintaining and Accelerating Economic Growth</p> <p>Enterprise and Innovation</p> <p>External Linkages</p> <p>Education and Training</p> <p>Community Security</p> <p>Social Assistance</p> <p>Health and Disability Services</p> <p>Treaty Claims Settlement</p>
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A further document was produced in 1995 with the title *New Opportunities – Government Strategy Statement – Towards 2010* and another document *The Next Three Years Towards 2010* was developed in addition to the annual documents accompanying the budget policy statement. In this the prime minister laid out his key strategic goals for a ‘tax reduction and social policy programme’. In it also, the chief executive of DPMC, Simon Murdoch, explained how this whole system is intended to operate. His preface is contained in Table 11.3.

TABLE 11.3: Preface from *The Next Three Years Towards 2010*

<p><i>Preface</i></p> <p><i>The Next Three Years</i> is a Government document setting out the National Government’s policy and programme priorities for the current term of office.</p> <p>In 1993 the Government adopted <i>Path to 2010</i> as a general statement of government policy and a vision of New Zealand into the next century.</p> <p><i>The Next Three Years</i> provides specific objectives and a work programme for achieving the vision set out in <i>Path to 2010</i></p>

In 1998 the government reframed SRAs as 'overarching goals and strategic priorities', with the intention of focusing on more key outcomes.²³⁷ These goals and priorities fulfilled the same role as the SRAs as statements of desired outcomes that set the scene for departments and ministries to develop KRAs. The 1999 Labour/Alliance government has continued the practice of setting high-level goals. It has six goals to guide public sector policy and performance.

In a paper to the New Zealand Institute of Public Administration, Simon Murdoch summarised the SRA/KRA system.²³⁸ He described it as operating as a 'strategic governor' that is intended to ensure that the daily energies of departments and chief executives are focused by a limited set of overarching long-term policy priorities against which milestones or progress could be assessed. He also noted that the 'blood lines' of the system go back to the Logan report in 1991 that saw a lack of strategic cohesiveness in the system as a weakness.

Murdoch also noted the significance of an annual meeting held at the prime minister's residence, Premier House, which inaugurates the annual budget cycle by identifying key priorities that will drive the budget. These meetings had predated SRAs but are enhanced by the SRA concept's potential to link the strategic objectives of the government with the budget process.

The relationship between politicians and public servants through the strategic process is critical to how and whether it works. In Murdoch's words:

SRAs link political vision with government policies and operations. They capture a notion of shared responsibilities because they pull ministers and departmental CEOs together.

The SRAs are cross-departmental and horizontal and, endeavour to provide a point of focus for policy directions that do not lie under the sole control of a minister or chief executive. The implication, therefore, is that they should be associated with a quite complex dialogue between ministers and chief executives across the formal constitutional and administrative boundaries. Their effective development, therefore, requires a good deal of subtlety in managing the fundamental separation of roles between ministers and departments in the manner noted in chapter five.

²³⁷ State Services Commission, *Assessing Departments' Capability to Contribute to Strategic Priorities*, Occasional Paper No 16, 1999.

²³⁸ Simon Murdoch, Speech to New Zealand Institute of Public Administration seminar, 1995.

Murdoch emphasised that the minister–departmental relationships are not vertical and hierarchical in the preparation of strategy. Two conference papers given in 1995 by Fancy and Matheson²³⁹ and Matheson²⁴⁰ go to some lengths to establish that this process is not a warmed-over version of ‘management by objectives’. They applied the term ‘strategic conversation’ to the process of developing broad strategic goals that are integrated with departmental annual budgets. The term emphasises Matheson’s view of the interaction across the constitutional boundary in the development of strategy.

Matheson noted that this dialogue affected not only the substance of the objectives that emerged but also the benefit of developing a sense of shared purpose and collegiality in the pursuit of the objectives horizontally as well as vertically. These thoughts are parallel to the conclusions of management writers in the private sector about effective strategic management processes.

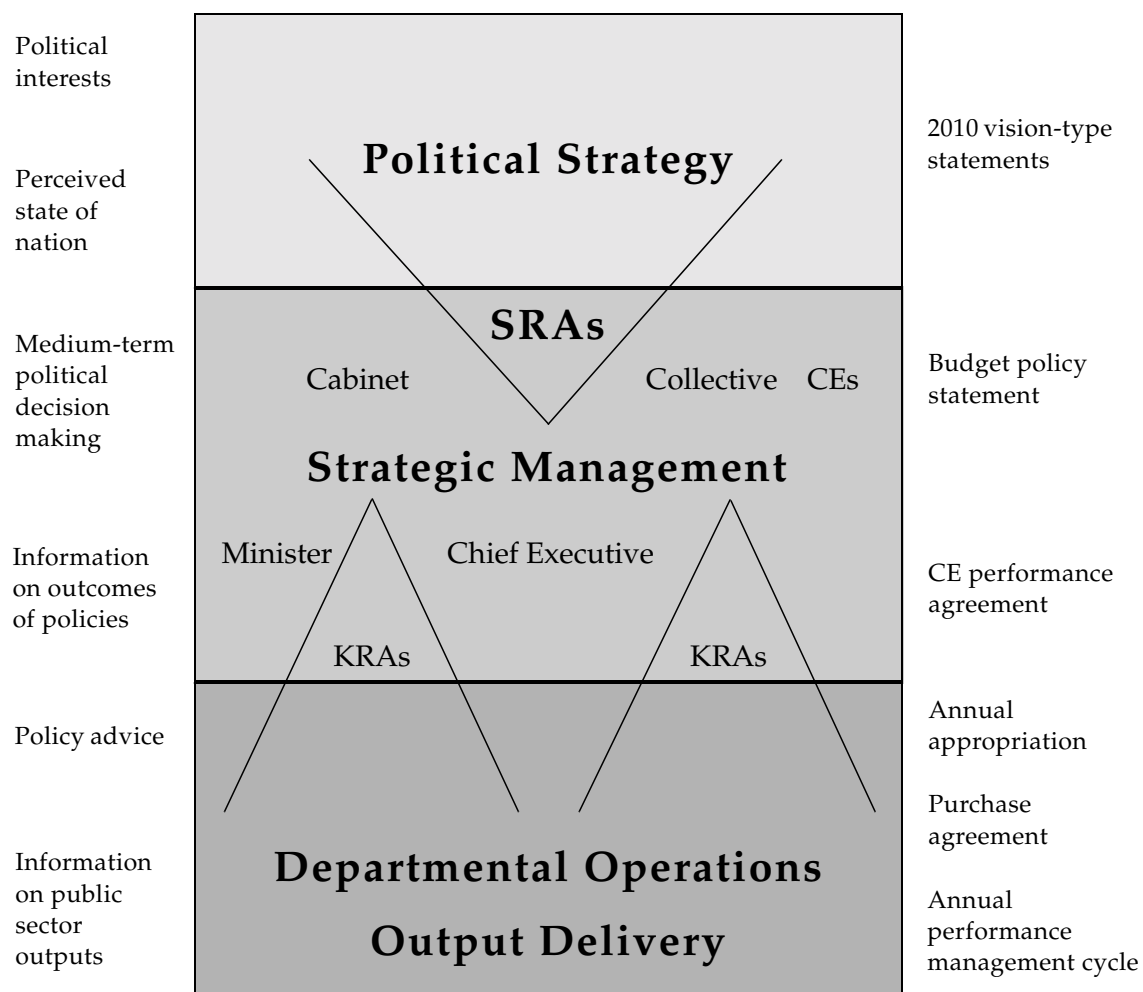
The SRA/KRA process has implications for the distinction between outputs and outcomes at the core of the public sector reforms. As discussed in chapter seven, managers commonly operate in circumstances where the information linking their actions in terms of outputs with desired outcomes is unclear or non-existent. For practical purposes managers deal with their ignorance of these connections by establishing general principles for their operations. They set down general objectives and decision criteria that they believe will enable them to align the organisation with its environment effectively and then adapt to information about their performance as they proceed. This is an aspect of the process of ‘muddling through’ noted earlier.

The SRA/KRA system has been regarded as a positive contribution by chief executives and others in a survey by the SSC. Murdoch’s and Matheson’s observations on the system point to a degree of satisfaction with its contribution, while showing considerable caution about what can be expected from it, and noting a number of actual and potential weaknesses. Murdoch notes that there are intrinsic risks with the system and draws attention to the following weaknesses:

- inattention because people do not put time into the strategic conversation;

²³⁹ Howard Fancy, and Alex Matheson, “Future Directions in Public Management in New Zealand: Towards Strategic Management”, paper to the New Zealand Society of Accountants conference, 1995.

²⁴⁰ Alex Matheson, “Strategic Management: of Salamanders and SRAs”, New Zealand Institute of Public Administration seminar, 1995.



Integration of budget and wider strategy formation

Strengthened "strategic conversation" interactive political/administrative decision making

Outcome information needed to fuel strategic decision making

FIGURE 11.3: Linking high-level political and policy goals with output specifications in the strategic management process

- bureaucratic compliance rather than creative strategic activity because the SRAs/KRAs become routine and lose the energy of the top-down/bottom-up interaction;
- budgetary corruption because they become used for bidding for 'new money';
- politicisation, by which it is meant that they remain a rather vague vision that is not tested in reality; and

- trivialisation that would occur if the SRAs/KRAs became excessively objective and quantitative and lost their essential qualitative flavour.

SRAs, like any strategy process, relegated many activities to non-strategic status. Those who equate 'strategic' with 'important' have sometimes sought inclusion of their work in SRAs. Linking a budget request to a vaguely related SRA had, perhaps inevitably, become a tactic for budget negotiation.

The 1999 Labour/Alliance government has dropped the SRA and KRA terminology. Along with its six high level goals, it has been working on setting goals for improvements in the social and economic status of Maori. The goal setting process is not universal across other areas of government priorities and it is not clear yet whether the use of specific goals will be extended to other areas.

The 2000/2001 proforma performance agreement for chief executives requires chief executives to develop two to four key priorities that are linked to the government's goals.

In effect, this results in a similar situation to the SRA/KRA system.

The policy analysis to support the high-level goals developed by the government, and more specific goals developed by the government or chief executives, should be improved in many areas. The translation of goals and priorities into detailed business plans needs tightening by relating them to groups of identified outputs, other interventions and outcomes. The linkages of strategic objectives into the medium-term fiscal policy and budget processes can also be improved. For example, a medium-term budgeting model for the health sector should be developed to examine trends and scenarios in health services and costs. The information emerging could then feed into the multi-year fiscal modelling required under the Fiscal Responsibility Act 1994.

Evaluation processes are needed of the government's policies to make assessments of the effectiveness of the policies in reaching outcome goals and to suggest improvements. The SSC needs to strengthen incentives on chief executives, through the performance management system, to be more accountable in practical ways for demonstrating improvements in the achievement of the outcomes with which the government's strategic goals are concerned. The SSC initiative that commenced in 1999 aims to integrate and revise the performance management system. It is attempting to focus performance requirements on to key goals for chief executives, for example, by requiring chief executives to identify how they will evaluate results.

Government goals and priorities are one element of a strategic management system and, while they are an important innovation in public

management, they cannot realise their full potential unless they are better integrated into the whole system of public sector management.

The Logan review²⁴¹ of the public sector management reforms emphasised concerns over the strategic capabilities of the government and the collective interests of the government. These two concerns are related. Requirements to be considerate of the collective interests of the government take on much greater meaning if those collective interests are expressed in terms of a coherent strategy that the different parts of the government are expected to work together to pursue. It is not easy for the government agencies to co-operate in the implementation of an incoherent or poorly articulated strategy. This is not to make light of any lack of concern for the collective interests of government by staff in government organisations, but to argue that the staff cannot fix the problem on their own. The government should have a clear vision of its role in the economy and society and its approach to carrying that out. There should also be clarity provided by government in the expectations of its agencies about their roles and performance in broad terms and the culture and values that will underpin the work of government. When the detailed performance requirements, management plans, values and cultures within separate agencies are synchronised with these wider policy requirements, the government then has strategic alignment.

LINKING STRATEGIC GOALS WITH OUTCOMES, OTHER INTERVENTIONS, OUTPUTS AND BUSINESS PLANS

A process for this strategic integration would be the development of draft strategic business plans by the government agencies. In years other than those immediately following the formation of a new government, these business plans would form a substratum for government-wide planning and could be considered along with other important material such as the government's manifesto and political imperatives. The plans should clearly inform ministers what is being delivered for the resources expended, to what ends, what low quality spending could be altered and what gains could be achieved with similar or increased spending. The DPMC could provide broad directions to the organisations to assist them in forming the boundaries for their planning. The organisations could present the information for the plans in a useful form for ministers to use in their work on priorities, directions and budgets.

²⁴¹ Logan, *loc cit.*

Some innovative work in this direction was undertaken in the implementation of the accountability framework for the Health Funding Authority. The statement of intent, the funding agreement, the service coverage statement and the internal accountabilities were all driven by a single strategic business plan. The purpose was to ensure that external accountabilities on the board could be traced explicitly through into the personal goals and budgets of managers. This method enabled stronger and clearer linkages between performance goals and budgets and, over time, linkages to service commitments and outcomes.

A unified strategic business plan permits the work of an organisation to be considered in a broad context of the environment, the objectives, the strategies, the outputs proposed and the outcomes being sought. This is a promising way to improve the performance and purchase agreements of departments and Crown entities, where there is frequently a dislocation between what can be achieved, what is being proposed and what is being paid for. The accountabilities for an organisation or Crown entity should be driven out of an effective strategic planning processes and not devised in isolation from a clear understanding of the best possible directions in a policy and managerial environment that has been well analysed. As organisations improve their planning skills, the strategic planning process could become an effective way to engage all key stakeholders, including the responsible ministers. These business plans could increasingly form a consistent network for planning at the 'whole of government' level.

Developing the strategic planning system of the Crown entities and organisations in this way would enhance the effectiveness of the monitoring of achievements in areas of strategic interest to the government and would also promote more effective performance assessments of chief executives by the SSC.

The emphasis on the strategic business plans would, as discussed in chapter seven, promote greater effort and scrutiny around the policy analysis that is needed to underpin proposals for funding outputs, aimed at important outcomes and strategic goals. This effort and scrutiny would also promote more attention to the evaluation of policies. In these ways a much improved strategic management cycle, building on and going beyond the current system of government goal setting, could be implemented.

As discussed in chapter eight, the SSC has been working with the Treasury to develop more effective accountability processes and documents. A 'statement of intent' is being trialled for departments and ministries that is essentially a strategic business plan. This appears to be a very promising move and could lead to better information for managers, monitors, ministers

and the public. The work required to produce this document should stimulate improved planning and management practices within organisations. The current minister of state services has indicated support for the use of strategic planning by departments and ministries that includes ownership components such as integrity, capability, strategic alignment and long-run effectiveness.²⁴² His proposal for what he calls 'a new capability, accountability and performance process for the public sector' brings together neatly the elements of an integrated strategic and operational management cycle. Its elements are:

- The minister and the chief executive agree together on how the department will give effect to the government's goals.
- The department carries out, or updates, its strategic planning, taking both a long-term and a short-term view.
- The long-term planning will take into account the components of ownership – integrity, capability, strategic alignment and long-run effectiveness – and will be captured in a strategic business plan.
- The deliverables for the coming year will go into an annual output agreement (similar to the present purchase agreement). The minister and the chief executive will jointly sign off on these documents.
- The central agencies and other monitoring agencies like Te Puni Kokiri will work with the department on what they expect to monitor and review during the upcoming year. This will form the basis for an agreed set of expectations.
- A dialogue involving all of the parties will continue during the year. After that, the agencies will aim to produce a consolidated assessment of departmental performance against the agreed expectations. This will, among other purposes, contribute to the state services commissioner's review of the chief executive's personal performance.
- The minister and the chief executive will jointly submit an annual report to parliament.

Setting strategic objectives in terms of outcomes

The suggestions made in chapter seven for building a consideration for outcomes more strongly on to the output-based management system would

²⁴² Hon Trevor Mallard, minister of state services, "Complying with the new government's priorities and plans for improving public sector performance and accountability", speech 3 May, 2000.

enable the strategic management processes to focus more on outcomes. To support this development, it would be possible in many areas of service delivery to set outcome targets for some years hence. From this would flow requirements for information collection, policy analysis and management planning that could be met realistically over the intervening years.

If, as discussed above, strategic business plans were developed across government to the point where they all indicated the linkages between strategic goals, outcomes, service standards, outputs, budgets and various risks, they would make it possible to be explicit and realistic about what the government could achieve. For example, a government goal concerned with reducing the gap between Maori and non-Maori socio-economic status could be translated into specific attainable commitments. At present it is difficult to see clearly what the government is doing precisely to address the gap and what can reasonably be expected in terms of outcomes. As a result, the budget process is not as responsive to strategic priorities as it could be.

In February 2000, the government announced that was going to hold its executives to account for outcomes for Maori. While this is how the management system should be used, it presupposes that policies that are capable of closing the gaps have been analysed, agreed to, provided with adequate resources and are capable of implementation. Generally, this is not the case. It is only symbolic to hold the secretary for education to account for gaps in educational attainment if there is not a body of analysis that shows why the gap has come about and what policies are likely to close it. It is probable that many influences on the education gap are well beyond the control of the Ministry of Education. There is no short cut to outcome-based management and accountability. It must be built up piecemeal, in the way discussed in chapter seven. The 'closing the gaps' policy is an example of the political difficulty that a government can create for itself by not thinking through the policy and management issues carefully.

Currently, there is a significant deficiency in information to make informed decisions and assess results across large areas of government activity. It is not possible to assess easily budget information and performance by departments and portfolios because the budget information is organised by 'votes'. Further, outcomes are stated vaguely and are not reported on. The only interventions linked to outcomes are outputs and these linkages are often weak.

The Treasury has become active in promoting some potentially significant improvements to processes for linking government goals to the work of the government agencies. These involve proposals for:

- regular reporting on current states of society (that is, 'outcomes'). There is currently no reporting of outcomes;
- inclusion of statements in the budget documents of the purpose and logic behind all appropriations, and not just for outputs, to help assessments to be made of the case for the intervention and how its effectiveness might be judged;
- improvements to the accountability documents to place the department and ministry outputs in the context of outcomes (work undertaken in association with the State Services Commission);
- listing of major evaluations of effectiveness being undertaken by departments and ministries in budget documents (to allow an assessment of the scope of the evaluation work).

If adopted, these changes could improve the ability of the government to understand better the impacts of interventions and improve the quality of decision making about the allocation of resources. The changes could also improve the ability of parliament to assess what outcomes the government expects from its spending, whether the outcomes are being achieved and whether the spending is effective.

Another critical weakness is the failure to incorporate the Crown entities and SOEs into the budget documents, apart from single lines relating to net worth. In future these accounts will be fully consolidated in order to meet new accounting standards. This will provide a much more comprehensive view of the government's position and performance. When SOEs were run at arm's length from ministers in the 1980s, full consolidation was not required, in my view, at the time, although other commentators disagree. With the creeping re-assertion of ministerial influence in the 1990s it now is.

REORGANISING GOVERNMENT TO ENHANCE STRATEGIC EFFECTIVENESS

There is a case for modifying the structures of central government to address persistent weaknesses in strategic analysis and to promote more effective and stable processes for doing so.

One of the tenets of public management reform in the 1980s was structural reform. Amongst several principles applied was the separation of policy implementation from operations. This change addressed serious problems with regard to the capture of policy advice by the operational arms of government. The Ministry of Works and Development and, to a lesser extent, the Department of Scientific and Industrial Research were, perhaps,

the most outstanding examples of policy capture but there were many others. Problems of this kind persisted until recent years in the major areas of social policy.

Structural separation of policy or operations, like any principle, can be taken too far and implemented in a way that over-emphasises its benefits by comparison with other policy measures. The repeated application of the principle and the failure of government to take complementary action through other management techniques has led to the creation of a large number of small policy advisory bodies. These small units often have difficulty in assembling the critical mass of resources, management and culture necessary for excellence in policy work. This is not due to size alone, because some small units have been successful. Budgets, human resource strategies, the skills of chief executives, the political orientation of ministers and the influences of pressure groups have all influenced the performance of these policy advisory bodies. The question of structure is, however, worthy of careful evaluation and reconsideration by government on the basis of the lessons learned. The effort should be made by the SSC and senior officials to clarify to the government what those lessons are.

The former prime minister spoke in 1998 of reducing the number of government departments to 15 although no analysis of this recommendation has been made public to support this number. A sound analysis would begin with a factual breakdown of the public sector situation in terms of the factors discussed in this chapter and in earlier work by the SSC and other commentators on the requirements of organisations to undertake good policy work. Once the reasons for weaker performance are identified, measures could be suggested to address them and from this it would become clear what the numbers and functions of departments should be.

The sections below discuss some of the issues that should be addressed and make some specific suggestions for change.

Co-ordination of officials' policy advice

While there is much to be gained from developing consensus among officials and in ensuring consistency of standards in analysis, there should be healthy debate and constructive tension on controversial subjects, especially when the need to address them first arises. These debates should not be 'co-ordinated' out of the management system, even though there must be sound processes for insisting on high standards of evidence and analysis, and pressure to resolve issues and move on. This process can take time and it is a mistake to go too fast. The time lags required to get policy prescriptions right

are a major reason why efforts to address issues in strategic policy and planning are needed when there is still time to get the policy done properly. The role of senior officials is crucial in planning the flow of advice, co-ordinating the parties involved, and isolating issues for political resolution in accordance with the cabinet's priorities.

Experience over many years suggests that the effectiveness of co-ordination in advice that takes place within government is heavily affected by the preferences and personalities of the prime minister and the minister of finance, and since 1996, the treasurer.²⁴³ If there are substantial tensions between these people, then officials will find it difficult to co-ordinate advice in the pursuit of commonly held strategic objectives. Rather, the minister of finance or the treasurer will be required to fight their battles in cabinet on the basis of advice from the Treasury and others. Co-ordination of advice below cabinet level will be difficult, as seen in the period from 1987 to 1989 when problems emerged between the prime minister and the minister of finance. This fact is recognised by the senior politicians in the Labour Party who were ministers in the last Labour government. The Hon Michael Cullen has expressed this view and has argued for having the top economic and financial role in the cabinet come from the same party as the prime minister in a coalition.²⁴⁴ There is much to commend the argument for the reasons discussed here.

The role of the Prime Minister's Department in policy co-ordination has ebbed and flowed since the founding of an advisory group in 1975. The original concept was developed by its first permanent head, Bernard Galvin, who managed a group of about seven people who were seconded from the public and private sectors for one or two years as members of what the then prime minister called his 'liaison group'. He resisted the title of 'advisory group'. The group set the pattern of focusing on the major issues of the day, from the Arthur Allan Thomas case to issues of closer economic relations (CER) between New Zealand and Australia and Springbok rugby tours. It did not attempt broader strategic planning which was the province of the New Zealand Planning Council. This pattern continued until the advisory group was cut back under the Lange administration and headed by a person who did not have the senior civil service background that was required to play a significant role in co-ordinating the bureaucracy.

²⁴³ The 1999 Labour/Alliance government has allocated the minister of finance and treasurer portfolios to one minister.

²⁴⁴ *The Dominion*, 27 July, 1998 p 10.

In the late 1980s the SSC and a former secretary to the Treasury, Henry Lang, conducted a review that strengthened the role of the Prime Minister's Department in the co-ordination of advisory work. It was again headed by a senior career civil servant and became the Department of the Prime Minister and Cabinet. The backgrounds and views of particular individuals, rather than a 'departmental line', have heavily influenced the advisory group's views on many issues. At that time, the department preferred a role in practical work on the issues to do with the co-ordination of departmental strategies. These departmental characteristics could be debated and were not necessarily weaknesses. They were presumably a reflection of the prime minister's requirements and orientations. Formally, the Department of the Prime Minister and Cabinet was intended to play a greater role in co-ordinating policy advice, although this advice was variable in its effectiveness through until the early 1990s. The failure of officials to co-ordinate advice over the reform of company law at that time is commonly cited as an example of such problems. The Ministry of Justice effectively blocked the progress of the law reform issue for a long time. It was one of the most serious failures in departmental co-ordination of advice, even though there were determined efforts by central agencies to repair the breakdown. In 2000 another review to develop the role of the DPMC further was initiated.

Until the end of the Muldoon era, the co-ordination role of officials in developing advice was centred on economic policy and trade policy, with the Treasury at the centre through its chairing of the Officials' Economic Committee. Treasury's co-ordinating role was removed by the Labour government after 1984, when it was no longer a requirement that papers going to a cabinet subcommittee be signed by a senior Treasury official. The senior chief executives continued to meet in a formal committee that dealt mostly with communication among chief executives over fiscal policy and financial management reform. The committee did not have the authority to bring forward consensus advice on other major issues. Ministers tended to do the policy co-ordination themselves on the basis of different lines of advice from officials, often in conflict. Papers to cabinet noted which departments had been consulted in the preparation of policy advice. Consistent with this, the Treasury's influence on government strategy was channelled through the minister of finance, who received advice on any matter going to cabinet that had economic or financial implications.

During the 1980s, and in the National government until 1993, powerful ministers, particularly the finance minister, developed the government's strategy, supported by their departments. Lateral co-ordination across

departments, and with the large number of groups of policy advisers outside the civil service, tended to be designed around the issues under consideration.

It was common for the cabinet in the Labour government to designate the membership and chairing of advisory machinery on an issue. The department heads had previously done this designating. At one point in the late 1980s, there were 17 different advisory groups established by the cabinet in areas of social policy. Some never met.

In 1988, the heads of the Prime Minister's Department, the Treasury and the Department of Labour were tasked with preparing strategic advice to the cabinet on economic policy and aspects of social policy. These ad hoc targeted arrangements, together with more routine, traditional processes of co-ordination, suited the culture of the government at that time. From 1984 to about 1991, these arrangements ran in parallel with the traditional advisory structures – relying on co-ordination by the Treasury of the budget process, together with the Prime Minister's Department and SSC co-ordinating activities in their respective areas. The National government, elected in 1990, saw these arrangements as excessively fragmented and lacking in overall cohesion. The prime minister, in particular, was concerned that departments were pursuing sectoral interests at the expense of some larger whole. Ruth Richardson, as minister of finance, sought to establish a clear strategic direction for the government in the strategy documents accompanying the 1991 and 1992 budgets. There was resistance to these by her cabinet colleagues, although, in general, the cabinet adopted the substance of the strategy in subsequent years.

After 1992, more effort was exerted across the cabinet as a whole to co-ordinate advice and to seek its expression in formal published strategy documents. In 1993, the DPMC took on a central role in the development of new strategic concepts described above. This change was a result of the clear evidence of difficulty experienced by the government arising from poor co-ordination of the flow of advice on the big issues facing it and from the culmination of dissatisfaction among senior officials. Tension among senior ministers over the directions of policy at the time were a major contributing influence. Well-publicised problems in reaching agreement over tax policy were a particular concern.

Since 1993, the DPMC has become more influential. It is placed at the apex of the officials' advisory committees as chair of the Officials' Strategy Committee that advises the most powerful cabinet committee. Issues in other officials' committees can be referred to the Officials' Strategy Committee for review and may be taken over by an official from the DPMC.

These arrangements have evolved incrementally and make good sense. The weaknesses in strategic policy advice and co-ordination that are in evidence are not about structures primarily but about the associated processes and weaknesses in human resources and the organisational culture that is needed for this demanding work in the advisory departments. As the role of DPMC develops in co-ordinating the strategic planning processes at the whole of the government level, it will be necessary for the DPMC to continue to enhance its own human resources to meet this challenge. In recent years, the DPMC has employed a few very senior officials with extensive policy backgrounds. This approach was regarded as a successful change to the normal pattern of employing more junior appointees and has subsequently been repeated with much to commend it. The DPMC cannot take on a role in strategy co-ordination and analysis without senior staff with high professional qualifications in their fields and 'clout' within the system.

The roles of the Treasury and the SSC in the co-ordination of advice also need clarification. There is always a natural suspicion that a finance ministry will bring a fiscal bias to its work. This is partly the ministry's job and it will keep its biases under control so long as it has an overarching commitment to the performance of the economy as a whole and a coherent view of social policy, rather than being concerned only for the government's short-term finances. The SSC needs involvement, at least to the extent that it is well informed, to make judgements in its performance assessments about the quality of policy work being done by ministries. The three central agencies need to work together from their individual perspectives to use their influences to shape uniformly high quality policy work across the government. The SSC and the Treasury can do much to ensure that linkages between high-level policy and strategic business plans are well-formed through their responsibilities for performance management, budget preparation and monitoring.

The desire of senior ministers for better consistency and co-ordination in strategic policy advice will have a more important influence than anything that officials can do to improve their co-ordination. The new government in 2000, for example, largely cut officials out of their deliberations in cabinet subcommittees and the prime minister was harshly critical of officials who sought to offer advice on the implications of the new government's policies. She told officials at the time that she provided them with a statement of the government's key objectives, that she was providing it because they wanted it, and she warned them that there is a fine line between giving free and frank advice and obstructing the government's policies.

As history has shown repeatedly, a government will get as much co-ordination in policy and administration from officials as it wants. It is not clear yet how much the present government will want. History says that it will want more later in its term than it wants to begin with.

Arrangement of portfolios

The ability of the government to make and evaluate strategies is influenced by the roles, structures and processes inside the cabinet. Chapter five discusses arrangements for these that could enhance the strategic capability of the government.

CROSS-DEPARTMENTAL CO-ORDINATION

Co-ordination has to extend beyond policy preparation and into implementation. The best policy will be judged a failure if it is ineptly implemented.

The 1993 health reforms provide an example of badly implemented policy. Interviews with a large number of the people involved with the reforms pointed to problems in implementation that were sufficiently serious to compromise the whole health policy, even in the eyes of those who believed strongly in the policy framework. Governments have shown their competence in implementing large-scale reforms in other areas, so the problems in the implementation of health sector changes are a case of performance below par. A near universal comment in respect of the reforms was that there was a breakdown in the co-ordination of their components. There were separately established units tasked with policy development, establishment of the Crown Health Enterprises and the Regional Health Authorities and other functions. The Ministry of Health was in transition between chief executives and was not in shape to co-ordinate the reforms. As secretary to the Treasury at the time, I raised the problem with the prime minister. The co-ordination role was given to the DPMC, but too late for it to bring the parties together into a well co-ordinated approach. The patterns of behaviour were already set in place. Communications with people who were to be affected by the reforms were late and ultimately inadequate.

While these health reforms were very large in scale and complex, both technically and politically, there are few strategic policies that are not vulnerable to the quality of implementation. Getting this right is rarely easy. A rule of thumb in the Treasury's tax division used to be that only about 10 percent of the work had been done when the cabinet made a decision

about a change in tax policy. The follow-up work needed for implementation is the other 90 percent.

The three-year electoral cycle always puts pressure on timeframes for policy implementation. This makes it imperative that a government that wants its policies to be seen in action within three years has to be quick about its policy analysis and masterful in implementing it where it involves complex organisational changes. For a high-performing government this means great skill in implementation is essential.

Further, beyond the implementation of new policies, the co-ordination of multiple organisations is increasingly necessary for continuing service delivery. Some of the most pressing issues on the previous government's agenda, for example, 'strengthening families' and addressing welfare dependency, run across traditional departmental boundaries and go beyond central departments to involve Crown entities and non-government organisations. Cross-departmental linkages are more necessary than ever from the level of strategic policy analyses through to the point of contact with the public. These linkages require refinement in the allocation of roles and accountabilities and in establishing networks and processes.

New cross-departmental groups were added to longstanding ones during the Shipley government to address these problems. The director-general of social welfare, for example, led a group involved with welfare issues. Arrangements have been made for social agencies to nominate a lead agency to co-ordinate the responses of the others to the situations of particular families. No evaluation of the effectiveness of these groups is available, although the participants generally report they are useful and offer efficiencies where citizens are receiving services from numerous government bodies. The ministers in the last government who were involved say they were pleased with how these arrangements worked. The co-operation between social policy agencies to provide a more integrated response to families in difficult circumstances is an important development in public management.

The amalgamation of the employment service and the income support service is another approach to co-ordination that foreshadows further amalgamations, that is, if it proves to be a success. It is not, however, practicable to solve all the major co-ordination problems by departmental amalgamations. Nor is it likely to be desirable in many cases. The separations were made for a reason, to avoid the non-transparency and loss of information that a conglomerate organisation always creates. We should not forget the difficulties of the past with conglomerate departments as referred

to elsewhere in this book. The decision by the government to put its purchase and ownership interests in the public health sector into a conglomerate ministry of health will be a test of this amalgamation proposition. I think that it is unlikely to work satisfactorily.

Networking among service providers is likely to be more efficient and effective in many cases where the basics of good management are in place. Staff from different organisations will not be able to respond creatively in concert at the point of contact with citizens unless they are empowered to make decisions by the management systems and culture of their individual organisations. In other words, effective co-ordination is not possible without decentralisation of management systems.

Past experience suggests that inter-departmental groups can find it very difficult to crunch issues that involve a loss of resources or territory by any one department. The minister of state services' speech to a public sector conference in 1997 expressed exasperation by ministers at inter-departmental turf battles, suggesting that all was not well as regards inter-departmental co-operation.²⁴⁵ Effective joint departmental work requires leadership, high-quality analyses, a mutual commitment to the issues and a willingness to break past patterns. This is difficult to achieve and requires a combination of people, resources and processes, which is not as common as it should be. It will be interesting to compare the attempts at co-ordinated service delivery in New Zealand with what emerges in time from the Department of Health and Human Services in South Australia, where health, housing and family services have all been brought under common management to promote better integration.

Under output budgeting, a cluster of outputs associated with a particular policy objective could be made the responsibility of a programme manager who also has responsibility for a budget that pays for outputs from several organisations. So far, this has only been done in a loose way through committees of ministers in related portfolios. It should be tightened up by establishing programme managers, which could be a lead agency responsible to ministers for a programme of outputs that runs across several departments. Using the system in this way should also promote a focus on outcomes and make it easier to develop the policy analysis that is needed to support cross-departmental programmes.

In my experience there is great benefit in making the effort to establish the principles and processes of engagement between government organisations

²⁴⁵ Jenny Shipley, *loc cit.*

that will have to work closely together. The written 'relationship agreements' that the HFA established with the Ministry of Health, the negotiators for the hospitals and iwi organisations were very helpful in developing more productive approaches to matters that required joint efforts.

Particular cross-departmental activities will ebb and flow in their importance over time. It would be a mistake to restructure the public service every time new activities became important. It has been demonstrated that a virtual ministry can work effectively to bring several departments together to manage a complex initiative. The "Bright Futures" programme launched by the government in 1999 and led by the Ministry of Commerce is a good example.

The SSC has these questions of cross-agency relationships in its core business plan and it should expand its concern for the effectiveness of the cross-departmental arrangements around the government's key strategic goals and its major operational programmes. It should work closely with the DPMC and the Treasury in bringing together these arrangements so that policy is coherent and budgets allocated and monitored. It should not, however, undertake the role of co-ordination itself.

CONCLUSION

Strategic coherence is concerned with dynamic efficiency and effectiveness. It is about an organisation doing the right things as well as doing things right. It is also about building synergy and teamwork in all the critical component organs of government. It is not possible for the government to achieve a high degree of strategic coherence as a whole if any of its key constituent organisations are struggling to produce high-quality strategic thinking and management in their individual areas. Such coherence is built from the bottom up as well as requiring clear thinking and decision making at the top. The flows of influence also run across the government as well as up and down. The decentralised management system and the methods available for specifying performance make it possible to establish accountabilities that run across departmental boundaries.

Strategy emerges from the processes of open enquiry, creative thinking and constructive dialogue. While strategy must be linked to the management and political systems, its generation often occurs away from the formal processes associated with these systems. The effort must be made to create the circumstances in which strategic thinking is not suppressed by rivalry, territoriality and 'one-upmanship'. It would be a disaster for the impulse to

improve strategic coherence to be co-opted accidentally into a very rigid system of central planning and control.

There needs to be more appreciation of the validity of the view, expressed by Matheson, that managers across the public service must develop a wider understanding of the means by which a devolved management system achieves strategic coherence.²⁴⁶ There has been a past pattern of weakness in strategic management in some key ministries and departments. Strategic policy analysis is always challenging and is easily crowded off the agendas of busy managers who may find it difficult to do.

The evidence shows that the process of strategic management is incomplete and not firmly embedded within the system of government and the public sector. There are key gaps in the quality of goal settings (defining outcomes), the absence of *ex post* reporting on government goals and weak linkages between departmental outputs and government goals. There is also an absence of information linking other interventions to government goals. The problems in assessing intentions and performance by departments and ministerial portfolios due to information in the budget being organised by votes need to be considered. The Treasury is working on proposals to address these areas of policy weakness. The absence of full information on Crown entities and SOEs in the budget and in financial reporting information will be remedied by changes to accounting standards in line with international best practice.

The processes that have been developed for linking chief executive performance agreements with a wider concept of government strategy are logical and fit comfortably with the other structures and processes of the management of core government. But the agreements are incomplete in major respects and are not always grounded in sound policy development, orderly decision processes and evaluation. Performance specifications and connections to the budget and performance management processes can be improved substantially.

More effective strategic business planning processes in departments and Crown entities should be used to integrate internal and external accountabilities and promote better budgeting at the strategic management level. These processes could result in plans that would increasingly form a substratum for better planning at a 'whole of government' level. Evaluation and operational policy analysis would also be promoted if business planning and budgeting was required to rely more on evidence of effectiveness. Some

²⁴⁶ Matheson, *loc cit.*

moves in developing better planning processes and accountability arrangements appear likely with the piloting of a new accountability document and associated processes in 2000.

The SSC should see a chief executive's weakness in policy development, evaluation, strategic planning and strategic management as a significant negative aspect of a chief executive's performance. This should apply even if the administration and management of the department is otherwise satisfactory and the minister is not complaining about weaknesses in the area. The chief executive's ability to have their organisation take a long view of the future and identify opportunities to enhance the welfare of New Zealanders through greater effectiveness and efficiency in the organisation's operations is one of the hallmarks of the transition from manager to leader.

Murdoch was correct in emphasising that the system of strategic management depends crucially on the commitment of the prime minister.²⁴⁷ Years of experience show that the government in New Zealand is as co-ordinated as the prime minister wants it to be. The management system will not function effectively in the presence of major conflict between senior ministers or coalition partners. In these circumstances, policies will lack strategic coherence and government departments will simply have to live with this lack. Sound processes of analysis and discussion can, however, often resolve tensions between ministers.

A renewed effort is needed to get the best of a decentralised management system that empowers local public servants to respond to local needs, while having the whole public management system motivated towards clear strategic goals. Without this, the public service will be at risk of being left floundering in an effort to administer instructions that have emerged from political deals that follow a short-term political logic, but that amount to incoherent and inconsistent policy.

Most governments world-wide suffer from behaviours in the executive that cause a lack of discipline in fiscal management, strategic incoherence and micro interference in operations that disrupt service delivery. Ministers who find strategic policy making too hard soon find themselves in side-show alley. A sound approach to strategic management is necessary to bring together politics, policy and management in a way that avoids these dangers. There is much more that New Zealand governments could do to improve their capabilities in this area of management.

²⁴⁷ Murdoch, *loc cit.*

MOVING FORWARD

INTRODUCTION

Any broad-scale assessment of the management at the core of the government must acknowledge the problem of the benchmark or counterfactual against which it is to be compared. The difficulties of this are noted in chapter two and there is really no satisfactory answer to the problem. My assessment is based on the consideration of a list of major topics I believe to be important. These cover particular aspects of the management system including the attempts of government, through strategic management and capability building, to make the whole system's performance over time more than the sum of its parts. This chapter includes some concluding observations on these topics. It begins, however, with a speculative note on the question of what might otherwise have occurred if the path of public sector reform had been a different one.

An alternative path

New Zealand's public management system was going to change one way or another when the reign of Sir Robert Muldoon came to end. While it is conventional wisdom for 'the left' to describe the period of radicalism as beginning in 1984, the policies of the government after the 1981 election were just as radical in terms of imposing an Eastern European regime of economic controls and state-sponsored investment in heavy industry. The National Development Act 1979 and the Economic Stabilisation Act 1948 were used to force the economic reform programme through a compliant parliament. Those were not ordinary times. Both the Muldoon administration and the Lange government showed, in their policies, a belief that a sharp shift in the role of the state in the economy was needed, first towards expansion of the state's role and then towards its contraction. The pendulum lurched from side to side.

Ministers and permanent secretaries, lined up in matching hierarchies, had long been engaged in a comfortable dialogue while waiting in turn to get the top jobs as their older colleagues retired. This was swept away. Stable public institutions, with their resources indexed to inflation, had not really challenged their thinking processes for years. They were confronted with huge issues that they were ill prepared to address. An army of public servants who had been administering regulations was suddenly redundant.

The Reserve Bank of New Zealand struggled to keep monetary control. The fiscal deficit loomed ominously in spite of the Labour government's aggressive tax reforms to introduce the goods and services tax (GST) and to eliminate tax concessions and subsidies to agriculture and industry. There was a serious public sector structural fiscal deficit and government debt was ballooning. The traditional techniques of making expenditure cuts across the board were inadequate and politicians demanded new systems for setting priorities and addressing inefficiencies. In both practical and ideological terms, the instruments of the welfare state were facing major re-examination.

Within the public service tensions were building rapidly as 1960s graduates rose up the management ranks and agitated for change in management systems dominated by middle-aged men who usually had lesser qualifications. Women were no longer prepared to tolerate the lazy sexism that accompanied life in the public service. Decent blokes, with their wives at home with the kids, imposed enormous detriment on the careers of the women who wanted to stay at work and raise children. The new policy challenges demanded skills in analysis that many in senior positions did not have and the hierarchical management structures began to crack as new ministers sought the advice of younger policy analysts.

The growing insistence of demands by Maori for recognition of Treaty of Waitangi rights and for new approaches to addressing their concerns exposed ignorance and indifference to emerging issues in relationships between the Crown and Maori.

The reforms were one of the ways the public sector responded to this sea change. It might have been done differently but any assessment of the changes must account for the circumstances in which they arose, as discussed in chapter two. The most likely alternative track would have been to jog along a bit behind the reforms that were occurring in Australia at the time. This would have meant trying to resuscitate the system of programme budgeting, spending a lot of effort in evaluation of government programmes and trying to inject the results into the budget process. It would also have meant giving the Treasury a lot more power in controlling the expenditure baselines of departments. Fiscal control would have been on total administrative costs rather than outputs until the late 1990s when, following Australia, outputs would have been introduced. The shift from cash to accrual accounting would have been slower, there would have been a little more central control of wages and more political influence on top appointments. The privatisation process would have perhaps rolled along at a slower pace, although the fiscal wastage from poorly performing

commercial functions would have encouraged movement in this area. The Bank of New Zealand and the Development Finance Corporation would have gone belly up just as state-owned financial institutions did in Australia.

Would this have been an easier path of change? Possibly, but it is not all that much different and it would not have reflected the priorities of New Zealand governments. Australia began with a fiscal problem that was not nearly as severe as New Zealand's. Also, a large share of the Australian Federal budget is granted to states, whereas New Zealand was addressing fiscal demand that had roots in the role of government as a massive provider of private and public goods. The State of Victoria, which later faced problems much more similar to New Zealand's than those of other states in Australia, reformed its public sector in a way that is remarkably similar to New Zealand's reforms.

The public management system that was for some years known internationally as the New Zealand model is now also the Australian model in major respects and some features have become international best practice. The features associated with the role of the Department of Finance in Australia that helped control public sector expenditure and encourage efficiency gains were copied by New Zealand early on to add to the convergence that has since occurred. The implication is that New Zealand's reforms may once have been unique in certain respects but are not nearly as unique any longer. It is, therefore, valid to speculate that the path we have come down, in so far as public management is concerned, has led us to a place close to where we might well have reached anyway by another route.

Adapting public management to changing agendas

The 1987 Labour government was seeking from the public sector greater efficiency, better information, increased fiscal control, tighter accountability for delivering on the government's objectives, the ability to shift resources from low- to high-priority areas, and an end to the employment protections peculiar to the public service. There were significant gains made by the government in respect of every objective. Many critics might wish that these had not been the objectives but that is another debate.

Senior politicians throughout the 1990s, including prime ministers, ministers of state services and ministers of finance, have expressed satisfaction with the public management system in helping them to do their jobs. These comments have been summarised in the preceding chapters. The public management reform objectives changed from government to government and with the change of senior ministers. During the 1990s, there

were constant adjustments and some improvements to the management system, although these were too few and came too slowly. It is depressing to read reviews from the early 1990s pointing out weaknesses in the management system that are only now being addressed.

Satisfaction with the public management system depends on the ability to upgrade performance continually to meet new challenges. The 1980s reforms were related to the issues of the time. Today further improvements are needed and the new government, like those before it, will make changes to the management system. The emerging agenda of the new government has been considered in earlier chapters and a few final remarks are in order.

Most of the changes to the public management system can be expected to be adaptations that reflect new government priorities and that attend to specific issues of concern, but some may be fundamental in the sense of revising the underlying concepts to the system. In labour relations, the government has reflected its wider industrial relations policies of giving trade unions a privileged position as the bargaining agent of workers. The Labour/Alliance government is already tilting the system more strongly against departments contracting out services than the previous government had already done. The government has announced that there is to be a 'partnership' with the PSA that gives the union some roles and rights that are not yet well defined. There are some ministries where old bureaucratic management styles persist and consultative approaches to engaging staff in planning and managing change to effect better service delivery have never taken root. If the government's initiative helps promote more modern approaches to management and fruitful changes in organisational culture then it will be of use. If, however, it confuses the relationships between staff, chief executives and ministers then there will be problems.

The current minister of state services, the Hon Trevor Mallard, has outlined the three main changes that he expects his government to make to the public service. He has prefaced his explanations of the changes with the statement that the "underlying arrangements in the state sector – as they are encapsulated in the State Sector Act and the Public Finance Act – are satisfactory".²⁴⁸ He expects the changes in the next three years to be about "approach, style and culture and less about statute and structure".²⁴⁹

²⁴⁸ Hon Trevor Mallard, speech to Chen and Palmer seminar, 4 July, 2000.

²⁴⁹ *Ibid.*

Large-scale structural change is not, however, anticipated by the minister of state services, except in the health sector where I expect it will produce problems as it always has in the past.

A redefined role for the central agencies is expected to emerge slowly with a particular reference to the SSC 'facing up to the nature of its role'. More collaboration is expected in the state sector, with joint activities between government agencies and between the government and the public service union, local government and others.

Contradictory messages are beginning to emerge on the issue of central control versus devolution of financial and management control to government and non-government organisations. While bulk funding of schools is being abolished, it is being introduced to hospitals, although I expect that this policy will be modified as the reality of managing the relationships between central government and district health boards with locally elected monitors sinks in. There are likely to be far more central controls on the freedom of District Health Boards than was suggested by the policy in the government's manifesto. Experience and theory suggest that the preconditions for bulk funding are more favourable in schools than hospitals because the latter are much more heterogeneous in their service provision and costs and needs are harder to establish as a basis for population-based funding.

The general thrust of government policy announcements is to relax the government directions and controls and lower the transaction costs on organisations that provide public services with government funds. This is symbolised by the government's directions to some officials to stop using the words 'contract' and 'provider' in favour of the word 'partnership', together with the relaxing of funding methodologies in health as noted above. This general thrust contrasts, however, with the statement by the prime minister, in commenting on the inquiries into the Waipareira Trust, that:

I've always felt uneasy about whether adequate processes were in place to monitor and evaluate what was being done with public money. This issue has now arisen over Waipareira but ... it is an issue that goes far beyond Waipareira into the whole issue of contracting out. When the Government uses public money to contract core social functions it has to be sure the processes in place are adequate to monitor and evaluate what is being done. I don't think the last Government was anywhere near thorough enough in tracking it.²⁵⁰

²⁵⁰ *The Dominion*, 5 April, 2000, p 2.

The auditor-general, after investigating the Waipareira Trust, pointed to the need for agencies to develop robust general guidelines for managing their contracting relationship with non-government organisations. From this it can be inferred that directions, conditions and controls on public money going to non-government organisations (a purchase or funding contract by another name) are going to tighten.

The previous government's overdue initiative to improve governance and accountability arrangements for Crown entities is going ahead. From the papers to emerge so far, more work is required to resolve confusion about the instruments of accountability. While the initiative can be expected to tidy up the management and accountability mechanisms and styles, more work is needed to understand the interaction between these and the wider policy frameworks the Crown entities are implementing.

There are indications of problems in the government's use of the SOE model. For example, the intervention by ministers into the responsibilities of the Television New Zealand (TVNZ) board and management and the reported intervention by the board's newly appointed chairman into the normal responsibilities of management go beyond a liberal interpretation of the SOE policy.²⁵¹ TVNZ is an SOE and could be run in accordance with the provisions of the SOE legislation fairly satisfactorily. If the TVNZ board is not doing well in accordance with its statement of intent then the statement can be changed. If the shareholding ministers of TVNZ think that costs can be lowered, profits raised and capital withdrawn, then this can all be done through the statement of intent. A proportion of the public may not like the salaries paid to newsreaders and self-obsessed magazine show hosts but they do not have to watch them if they do not want to. If TVNZ top management is silly enough to pay higher salaries than necessary to employ the newsreaders it wants, then there are solutions available within the SOE model to deal with this. If enough people turn to other channels the advertisers will quickly force changes. Television is a competitive industry and unless this management-board relationship is sorted out quickly, TVNZ will be very vulnerable to its competitors taking advantage of the situation. Also, there will be a loss of public confidence if these interventions come to be seen as risking politicisation of the programming. The prime minister has made her view known that she thinks that a particular programme on the arts should be shown in prime time on TVNZ.

²⁵¹ *Sunday Star-Times*, 2 April, 2000, p A3.

If an element of the government's policy on culture involves taking TVNZ out of the market-competitive conditions that underpin the original SOE policy and back to a British Broadcasting Corporation (BBC)-style operation, then the SOE model is not suitable. If a mixture of commercial objectives and detailed public interest objectives is to be imposed, then a Crown entity is a more suitable form of organisation. The forthcoming Crown entity policy envisages more than one category of entity depending on the degree of independence the entity has from the government. Assuming that some of the problems currently apparent in the work on the various types of entities are resolved, one of these categories would surely be suitable as a management model for TVNZ and could be shored up with specific legislation that clarified the law with regard to the specific measures of independence that it had from government. While such an entity would be under greater government control in some respects, it would be more independent than the SOE model can ensure in respect of fundamental issues of the independence from government of a state broadcasting organisation.

The new government clearly has intentions to make further changes in the public management system. Some of what has been done to date looks reasonably promising and includes continuation of sensible initiatives from the previous government regarding Crown entities, streamlining performance management and monitoring. The new suite of government accountability documents looks very promising and will be an improvement so long as old habits of encrusting these instruments with excess detail that belongs in the annexes are resisted. However, some of the current initiatives have been on the lists of objectives of ministers of state services before, and not enough happened. A lot that was said by Rt Hon Jenny Shipley in 1997 overlaps with statements by the current government. A greater effort than we have seen from the executive level of the central agencies and agreement among senior ministers about what is to happen is necessary if the government is to pick up the reform pace and move to the frontiers of best practice internationally.

Some of the government's rhetoric is less productive than most of the decisions being made. The constant reiteration by the government of the need to remove contractualist systems and performance specifications from the performance agreements of public sector chief executives and with other public and private organisations has not yet shown up in reality and will get the government in trouble if it takes it too far. We should hope that it can recognise, when it sees it, the line between simplifying an accountability system, training people to use it properly, making it better aligned with the public interest and making a naïve leap into fuzzy notions of 'partnership'.

From what has been done by the government to date, there may be a lack of a clear and consistent way of thinking about the public management reform issues. This could, however, be an inconsistency between rhetoric and substance rather than a conflict between substantive measures. If the government undertakes substantial public sector change without developing a consistent approach, there will be trouble in specific areas and a substantial risk of declining departmental performance over all.

Even the harshest critics of the public management reforms acknowledge the benefits that have flowed from having a consistent framework to work from. Public management systems are, in general, robust and can have several things wrong before serious malfunction takes hold. Once it does, however, the effort to turn it around is long and arduous and may be unachievable if the malfunction involves a major collapse in capability, politicisation or widespread unethical behaviour. Consistency in the concepts of public management and coherence in policy implementation is a check on the tendency of governments to take ad hoc measures to address particular issues without considering the effects on the public management system as a whole.

Over most of the 1990s, ministers and officials were slow and unsteady in modifying the management system to address emerging new priorities and problems in the system. Initiatives were launched by the government but not followed through. Some important things were left to drift. The action lagged behind what was required and problems that might have been avoided have emerged. Some bad habits have been in evidence.²⁵² Innovation and leadership have tended to be carried out by particular individuals like Dame Margaret Bazley, John Chetwin and others rather than through a system-wide advance. In the last two years the level of interest in systematically superior public management has picked up again. The SSC is lifting the pace and has prepared a suite of useful papers that present developments in its thinking to a wider audience via its web pages. The SSC has worked up a new Crown entity policy and is refining the performance management system. In the coming year or so all this is likely to come to a head, which will set the scene for the next few years before the agenda shifts again, as it always does. Whether these adjustments are on a path of constant improvement or not depends on whether there is consistency, coherence, a

²⁵² I have listed my favourite bad habits in an address to the 1999 Public Sector conference sponsored by the SSC. It is available at the web site pssm.ssc.govt.nz/speakers/gscott.htm.

careful study of the experiences of the past and of best practice internationally, and feasible responses to the changing environment.

This book has considered many aspects of the public management system in some detail and has made suggestions in each chapter about clarification of concepts, lessons to be learned and changes to be made. Some major areas for further attention have emerged and I finish with a few summary remarks on each.

ROLES OF MINISTERS

Ministers have the ability to drive superior performance or to send distortions through the system that undermine the efficiency and effectiveness of a chief executive and a department. There has been a noticeable shift from ministers being advocates for their agencies in the budget process to taking rather more responsibility for setting the tasks of their departments and associated Crown entities. Some ministers are skilled in their purchasing role. They develop purchase and performance agreements and contribute to statements of intent that encourage the organisations for which they are responsible to produce a high quality mix of services, at prices or costs close to achievable benchmarks. They engage their agencies in strategic thinking processes that lead up to the formation of their accountability documents, which encourages the agencies to work hard at proposing the best mix of services to meet the government's objectives. Some ministers also approach the specification of requirements and subsequent monitoring in ways that encourage agencies to be active and innovative in managing their work to produce what is required.

On the other hand, every cabinet I am aware of has had ministers in it whose work is inadequate in these respects. Some ministers leave their departments demoralised and adrift. Senior public servants sometimes have to endure their ministers exploiting them for short-term political purposes and leaving them exposed to political attacks that they cannot defend themselves against within the established conventions of relations between ministers and public servants. Some ministers play favourites in their ministries, working around the chief executive and causing dysfunction in the management.

Quite a lot can be done to lift the performance of ministers and this issue should be given a lot more attention than it has received in the past. People should not be in these ministerial positions who have not acquired the skills and experience to carry these onerous responsibilities well.

Ministers are also taxed with their role of managing the politics associated with their portfolios and attending to duties in the cabinet and parliament. They require assistance in exercising their roles as purchasers and owners. This is available from professional advisers who can help to develop the accountability instruments for departments, but this assistance is unlikely to be sufficient. The central agencies need to continue their recent work in promoting the most effective models for these accountability instruments. They could be much more active in providing information about the best practices inside and outside the government. They could assist ministers to set expectations for efficiency and effectiveness. In the case of the SSC, more active monitoring of delivery against purchase agreements could be provided. The publication by the SSC of benchmarks and information on actual departmental performance could strengthen incentives at all levels of the public management system to lift, in a continuous way, the quality of departmental services, efficiency and capability.

The ability of ministers and the cabinet to function well and to provide good incentives to their agencies is affected by the organisation of responsibilities, the distribution of power and the decision-making processes within the government. The prime minister needs to be assured that ministers are performing and that their ministerial responsibilities match their capabilities. A regular portfolio review, encompassing information on the performance of the government agencies for which the minister is responsible, could lift the ability of the prime minister to monitor and manage this critical area. The formation of cabinet committees and ministerial teams by the National government in 1999 to work on clusters of related issues provided more effective capability than was there previously to assess, plan and manage the government's business.

The mixed member proportional electoral system has brought coalition governments that have paired up associate ministers and senior ministers from different parties, in an environment where the authority of a senior minister can be challenged if an associate minister disagrees with the direction taken. MMP has also brought inexperienced politicians into cabinet. A two-tiered cabinet, with an inner circle of experienced ministers leading an area of related portfolios, supported by junior ministers managing related operational portfolios, has the potential to alleviate many of these problems.

In this system, there would need to be agreement on the roles and authorities of senior and junior ministers, particularly in any coalition government. The status of coalition agreements should be clarified,

including who will speak with authority on their interpretation. There is a place for the codification of operating practices for coalition governments. Coalition parties would be wise to have an agreed process for determining any differences well before they erupted in the form of ministers tugging in opposite directions on the arms of their agencies. Differences in understandings about roles, responsibilities and operating practices can be the flash-point for the combustion of coalition governments. The 1996 coalition government learned these lessons the hard way and discovered that careful attention to roles and processes was critical.

CENTRAL AGENCIES

The central agencies can complement the influence of ministers on government agencies and can institutionalise the principles, values and practices of the public management system. This influence can be shaped into a more powerful influence for government agencies to perform well against their performance agreements and to develop themselves to meet future demands.

There are some opportunities for gains by increasing the usefulness of the monitoring work carried out by central agencies. Monitoring, however, is not always designed to encourage attention to important factors and is not always well integrated and co-ordinated. Information collected by the monitoring agencies is not always well used. There should be a greater emphasis on monitoring outputs and ownership matters, including measures that indicate how well the government agency is performing in areas critical to its ability to produce high-quality services now and into the future.

While building up the basis for an outcome-oriented public management system was always going to be piecemeal and slow, the central agencies have been lacking in commitment to push this as far as it could reasonably go. They should reinvigorate the vision of outcome-focused public management and use their positions to develop practical frameworks that set standards for this and create strong incentives for line organisations to do the necessary work. This should not be a naïve thrust, however, but should account for the real difficulties associated with analysis, human resources, management and accountability that were discussed in chapter seven.

The central agencies need to work very hard at ensuring that they are developing their own capabilities. The monitoring of government agencies requires sophisticated techniques and skilled and experienced people to carry it out. The monitoring of chief executives also requires this, as well as

wise heads who understand the requirements and standards expected of chief executives. The appointment by the SSC of one or more experienced deputy commissioners and the development of departmental in-house expertise should help monitoring in this respect. Alternatives to assist in the development of agency capabilities include contracting in assistance, rearranging the monitoring responsibilities of agencies, or developing cross-agency joint monitoring plans and sharing information.

STRATEGIC CAPABILITY AND CO-ORDINATION

Strategic thinking and cross-agency co-ordination are inter-related. The strategic management problems that governments face do not sit easily inside organisational boundaries and neither should the thinking about them. It is critical for government to have good strategic thinking between its ministers and between them and their officials, who should also undertake strategic thinking at their own initiative. The way that the cabinet organises itself can greatly influence its capability in strategic thinking. The remodelled cabinet committees and teams under the Shipley administration did not survive in their recognisable forms under the Labour/Alliance government. At the time of writing the new government cabinet committee pattern is not clear and leaves questions about how the government will develop new strategy once its manifesto promises are in place.

The budget process is a powerful tool for linking the strategic objectives of government to the outputs and funding of departments and Crown entities. A further step by the government of providing information on what is to be achieved from all the interventions summarised in the budget, not just outputs, could greatly enhance the quality of information for governmental decision making. Governments in the 1990s undertook useful steps to strengthen the strategic orientation of the budget through management processes. This development could be strengthened further. Spending agencies and ministries need to improve their policy, planning and evaluation work. This work could be used to enhance the development of government goals and other expressions of government strategic objectives, and to assess the progress made against these objectives. The government's goals could be linked to specific outcomes that could be measured and reported on. This would enhance the ability of government agencies to link their outputs and other interventions to the government's goals.

The challenges now facing governments increasingly involve the need to develop and execute strategic business plans across many agencies. There have been notable successes in teamwork across agencies in several areas of

government. The expectations for delivery from each agency within a cross-agency programme should be made clear and incorporated into each agency's performance agreement. A logical step is to allocate budgets to lead agencies that take responsibility for the contracting of services from other public organisations, in addition to non-government organisations, through purchase or funding contracts. Where cross-agency work is failing due to the negative behaviours of people, the SSC should be fast to deal with this and make its expectations clear to the chief executives in charge of the agency in question. Governments in the future will need to be able to respond well to complex cross-cutting issues and reliance on the voluntary co-operation of departments should be avoided. The roles and responsibilities of departments that are involved should be clearly defined in order to minimise friction between them.

CAPABILITY AND THE GOVERNMENT'S OWNERSHIP INTEREST IN DEPARTMENTS AND CROWN ENTITIES

The New Zealand public management system is capable of supporting overall fiscal control without the distortions that traditional across-the-board measures of fiscal policy often cause. There is financial flexibility at the management level within the overall public sector fiscal framework. Calls by departments for resources outside those budgeted for are rare by world standards.

There is a particular weakness, however, in the limited attention given by the government to ownership and capability issues of departments, such as developing the human and intellectual capital to meet future public sector demands. As the Rt Hon Simon Upton has noted, ministers are leaving a vacuum in not attending to the ownership interests that chief executives will have to fill. Some chief executives will do this. Others would benefit from stronger ministerial incentives to take action on ownership matters; incentives that could be powerful if crafted well in the hands of the ministers and monitored well by the central agencies. A menu of ownership indicators developed on the basis of advice from purchase advisers and the central agencies could be a very useful tool for those ministers willing to take up the challenge of creating powerful performance incentives around their agencies to enhance agency capability. In its briefing to the incoming government in 1999, the SSC stated "we know a lot more than a few years ago about the quality of management processes within departments, but we do not know quite enough to form authoritative judgements about: overall organisational

performance; whether the capability of departments is growing or eroding over time; and their ability to respond to government priorities and their external environment over the next two or three years". The SSC must get itself to a position where it can make such judgements.

Improved attention by ministers to the issue of ownership interests will not simply just happen. There need to be incentives to do this. These could come in the form of the prime minister taking a greater interest in these issues when conducting the portfolio reviews of ministers. It could also be assisted by the minister of state services having a stronger role in actively reviewing the ownership interests across the public sector and in providing advice to cabinet, ministers and the prime minister on areas of concern and opportunities for improvements. Having chief executives who care is not enough. Someone in cabinet must also care, especially when decisions are being made on investments and dis-investments in the public sector. Another incentive could be from the provision of better information to the prime minister by the SSC on the performance of departments and ministers' portfolios. This could be done through organising the budget and performance information on a performance basis, rather than on a vote basis. If ministers can see more clearly what is happening in their portfolios, they will have a better basis for seeking improvements to the various government interests of the departments that they are responsible for.

There is considerable potential for improving the performance of the government through lifting the policy and evaluation capabilities of its agencies. The peak of policy capability in New Zealand can match international standards, but the peaks are too rare. Agencies need to develop a culture that supports more strongly the production of high-quality policy and evaluation. Policy ministries should be particularly attuned to the need to develop a culture that supports public sector policy work. This means having critical mass in human resources (HR) and valuing the work of policy analysts. Agencies should have HR systems that help attract, develop and retain policy analysts. This process can involve a very active recruitment approach in the universities, the ongoing training of policy analysts, career paths for analysts and attractive levels of pay. Governments and ministers can do much to encourage good quality policy. They can also do much to diminish it. The pressure from some ministers in the early months of the Labour/Alliance government to suppress policy analysis that does not support their predetermined policy directions is worrying.

Too often, governments have reached for superficial solutions to complex issues, while the root of the problem in question lay buried beneath shallow

assessments of the issues and the options available. The government's policies for funding health care in the mid-1990s (the so-called 'efficient pricing theory') are an example of this. Governments will always make mistakes and, inevitably, unexpected side effects happen. However, a good government tries to understand these aberrations through evaluating previous interventions, and uses this knowledge to enrich the policies and strategies of the future. The vital links between the outcomes sought by the government and the outputs of agencies can only be made through the progressive building up of work in policy development and evaluation.

The impulse for better policy and evaluation could be strengthened if ministers asked for, and expected, this advice from departments and if the performance management system revealed these weaknesses. There are too many agencies that have not thoroughly assessed what they are required to produce from an internal management perspective and that consequently fail to understand completely the critical things they need to do. They lack practical indicators of their performance. Some agencies see monitoring as compliance geared to satisfying external governmental requirements while not being well-integrated into the agency's internal management system.

Agencies are greatly affected by the quality of their top management, particularly the chief executives. The pool from which chief executives and top managers are selected is not extensive, as was noted by a former prime minister and by the state services commissioner in his annual report for 2000. Some aspects of the public sector, such as the goldfish bowl environment, are unattractive to potential applicants. Other aspects of the public sector can be made more attractive to potential employees. Salary levels need to remain reasonably proximate to the levels available in the private sector. Expectations on chief executives can be framed in an accountability regime that is clear, targeted at important matters, capable of being aligned with internal accountability systems, and that is fairly and effectively monitored.

Succession planning and active recruitment and the development and retention of potential leaders should be high on the agendas of chief executives. This is not always the case and encouragement should be provided by ministers through requirements in the performance agreements of chief executives to achieve goals in these areas.

PUBLIC SECTOR ETHICS

There are several dimensions to the issue of values and ethics in public sector management. Economy, probity, commitment to serve the government and the public, managerial and professional excellence all come together.

The great majority of managers have handled their management freedoms well. Scandals are rare and any serious misdemeanours are dealt with through open and legal processes. Thankfully corruption involving money and unsavoury influence is extremely rare in the New Zealand public service. It is, however, arrogant to argue that there is something inherently incorruptible about New Zealanders or at least the public service. From working in many countries in Asia and elsewhere where corruption is endemic, I have observed two things. Their public servants are the same kind of people as New Zealand public servants with the same backgrounds and qualifications. Once corruption takes hold it is incredibly difficult to root it out as it feeds on a conspiracy of silence and the rule of mutually assured destruction. It is usually only the careless who get caught. Corruption is systemic and the authorities must ensure the system never gets started.

There have been a few departmental extravagances in New Zealand and the public expects them to be dealt with. Some are the result of oversights by busy executives rather than a profligate attitude. There will always be a few of these extravagances in a decentralised management system and mostly in start-up organisations when internal control systems are not fully embedded and new external recruits have not fully absorbed public sector norms. Some apparently expensive items that become the focus of public attention may be part of a larger situation that makes some sense, although the public does not see it. These symbolic events are often more important politically than they are in reality.

Centralised management systems do not control waste any better as a rule, although they can provide a superficial appearance of doing so. In the early 1980s, I took taxis from the Sydney airport to downtown Sydney and back to attend a business meeting, so that I could squeeze the meeting in on the way home from working in Canberra. I was not allowed to claim the fares back because there was a policy requirement for public servants to use airport buses. The claims clerk told me that I should have used the bus and stayed the night in Sydney.

Under the previous public sector management system permanent heads travelled first class but I doubt that any do today unless they need to sit with their ministers to work.

Strengthening of requirements for internal control and audit is the best way to keep problems to a minimum and the SSC could augment this with expected norms in sensitive areas, but it would be a mistake to return to generalised controls over inputs. How would input controls address, for example, what is acceptable as expenditure on training courses? The public is easily aroused by populist attacks on training that can be made to look

extravagant or unusual and there have been some apparent misjudgements made by executives over issues such as the chartering of an aircraft to transport departmental staff to a training seminar. But, just how easy is it for the government to set input controls rules that do more good than harm? Was the Hon Max Bradford right, on balance, to punish the military for sending staff to hear addresses by the greatest American general since McArthur and the Soviet president who brought the Union of Soviet Socialist Republics (USSR) to an end? Was there a cheaper way for the military staff to hear from these two? Is it for a minister to judge whether military staff would get value from hearing speakers such as these that would be commensurate with the cost of their attendance? Speaking for myself, I would have thought it odd if the military did not want to take advantage of such an opportunity. I attended the seminar and found these men to be simply inspiring. The best control is self control based in clear and well-embedded ethics of economy, backed by the accumulated lessons of experience.

Public sector ethics go well beyond probity and economy, however. The ethic of public service is essential to the conduct of public management and on this no one disagrees. Allen Schick did not argue that public sector ethics had eroded with the changes brought about by the reforms, but he worried that they might erode. If the public management system were causing an erosion in ethics, then obviously, it should be changed, but where is the evidence that it has? Why should there be a trade-off between having the right attitude and values and having a performance-oriented management system? There must be a way to bring performance management and ethics together if evidence shows up that this has not already been achieved.

A lot has been done by the SSC, over many years, to bring these together, but it should never lose sight of the need to keep the elements of good ethics and values of service to the public at the forefront of the public service in practical ways. As the understated conventions of the British public service tradition fade and the government is oriented increasingly towards Asia where there are widespread problems with ethics, it will become all the more important to maintain the effort to keep the New Zealand government's reputation as one of the most clean in the world.

CROWN ENTITIES

Crown entities are significant providers in the government sector. Many do their jobs well, but all are exposed to accountability frameworks that have weaknesses. There are accountabilities to parliament through meeting objectives set in legislation and performing against the 'statement of intent'. Ministers have an ambiguous role with respect to their degree of

responsibility for that 'statement of intent'. In addition, Crown entities have purchase or performance agreements and sometimes business plans that detail their accountabilities. They can also carry responsibilities under the Companies Act 1993 if they are incorporated under that Act.

Not surprisingly, there have been cases of confusion over roles and responsibilities of Crown entities. Sometimes these have related to the role of monitoring agencies and boards, where a monitoring agency has bypassed a board and dealt directly with staff. Sometimes there has been confusion over the role of ministers, with a minister bypassing the board and also dealing in detail with staff. Sometimes a Crown entity has been unclear about its degree of autonomy and ability to resist the wishes of ministers. Ministers can be quick to give informal directions to Crown entities and just as quick to distance themselves from criticisms of those entities. These are all symptoms of a lack of clarity in roles and responsibilities that causes confusion in the accountability frameworks of the Crown entities. This confusion can be largely resolved by designing workable accountability arrangements. The Crown entity initiative begun in 1999 by the SSC is grappling with governance and accountability issues, but is not fully focused yet on some of the associated key problems. The initiative deals inadequately with the health and education sectors and its categorisation of types of Crown entities does not rest on a solid enough analysis of problems and options.

The government should take more care in creating Crown entities and in removing or adjusting them. They are not just state-owned enterprises with more room for ministries and ministers to intervene. The policy work behind the creation of new entities must systematically assess: their role in a sector, what incentives will operate, what the flows of information will be and how the property rights will be arranged around the entity. We have learned from experience that failure to take a systematic approach to the formation of Crown entities can lead to dysfunctional organisations. This occurred when hospitals and Regional Health Authorities were treated as competitive organisations despite their existence inside a non-competitive hierarchical system, with under-developed mechanisms for resolving differences.

CHANGE

Governments have managed extensive changes in the past decade or so. Many of these changes were well managed but some were not and these leave lessons for the future. As Allen Schick observed, "what has been accomplished in New Zealand was unprecedented anywhere else in the world. There are risks, however, in pioneering in public management,

including the risk of having to learn from one's own experiences, rather than those of others".²⁵³

Slowness by government to act on problems has been apparent. In the case of Crown entities, weak accountability frameworks have been left in place for too long. Other examples are the government's slowness in reacting to problems in the development of information systems in the New Zealand Police, and a flat-footed approach to addressing problems between the board of the New Zealand Tourism Board and its responsible minister. Some ministries that have failed to deliver a reasonable level of quality in their policy work have been left to drift for too long.

On occasions, chief executives and chairs of boards who have failed to perform have not been assisted to get on top of things or moved on quickly enough. Ministers and monitoring agencies need to appreciate the consequences of lingering performance problems and the advantages of dealing squarely with them before they escalate. This is not about whetting the public appetite for dismissals. This concerns the government as a whole recognising its own performance problems quickly and responding to them methodically and in conformity with the principles of sound personnel and public management to put an end to a problem. Too often problems are left festering while people position themselves away from possible blame.

Sometimes reformers have been too quick to reach for structural solutions, without understanding fully what the problems are and what the consequences could be of various alternative interventions. Reformers also need to be aware of the toll that restructuring can take on an organisation. This is not to say that it should be avoided, but the costs and benefits need to be assessed. It can be very demotivating for good employees to have to reapply for positions several times within a space of a few years. The time required to reach satisfactory levels of performance needs to be recognised. It takes at least two years for organisations to implement successfully a large-scale restructuring and to begin to make gains from it.

Restructuring costs real money particularly in paying redundancies and in building new management systems. The seductive habit of saying that all costs of change will be met from the associated efficiency gains has been more than some organisations have been able to manage.

Changes to roles and structures should be built around sound assessments of the potential capability of organisations. Sometimes governments have overloaded organisations, endangering their ability to

²⁵³ Schick, *op cit*, p 9.

perform. The frequent policy and funding changes surrounding the new organisations in the health sector in the early years of the 1993 reforms are an example. Some organisations have been given mandates requiring levels of technical and management skill that have been difficult for them to achieve. Unresolved policy problems can be dropped into organisations from cabinet level, for managers to resolve. On occasions, there are structural factors that constrain the ability of managers to deal effectively with complex policy issues, particularly ones that stretch across many organisations.

All these lessons have been learned by people in the public sector management system, as well as those who have moved elsewhere. The opportunity to draw these lessons out more fully and make them available to future reformers, policy makers and politicians should be grasped. The central agencies, particularly the SSC, would be well placed to facilitate this valuable work in clarifying and embedding the lessons of experience.

MOVING FORWARDS

New Zealand has implemented far-reaching reforms in its public sector management system over the past decade-and-a-half and has a demonstrated capability to design and implement public management systems that are at the innovative edge of world practices. These systems have attracted the attention of governments of varying ideological hues around the world. Former vice president Gore was one who followed the development of the system closely and described New Zealand to the participants in his summit conference on reforming the US Federal government as the one country that had comprehensively 'reinvented' its government. The administrative head of Gore's reform initiative, Bob Stone, argued repeatedly with the sceptics of reform in the United States by pointing to what New Zealand had achieved.

There is depth and sophistication in the debate about public management in New Zealand that can be found in only very few other countries. New Zealand has leading-edge systems and technologies in some areas, for example, financial management and debt management. Many departments have raised their customer service and lowered costs with modern management and information technology. The registration of companies and the searching of land titles is up with the best practices anywhere and on the frontier of innovation. There are chief executives who have brought strong leadership and the best of modern management practices to bear on their departments and Crown entities. There are leaders like Mark Byers, in the Department of Corrections, who take on the task of pushing a complex

public institution up the curve of performance while facing everyday management challenges that make running a large private corporation look easy.

While some aspects of raising the managerial performance of government have been done very well, there are many problems yet to be addressed and there have also been a few disasters.

After years of public sector reviews and little movement, the period of drift is coming to an end. The influence of the Rt Hon Simon Upton initiated a renewal of energy and focus in the SSC to raise its capability to advise ministers and monitor chief executives more effectively. A potentially significant development is the redesign of the accountability provisions that carries the promise of associated improvements to planning, management and monitoring across the core public sector. Other signs of change lie in the emergence of policies and advice on e-government and the attention to performance problems in Crown entities. The Treasury has developed proposals to improve the information in the budget documents that could potentially provide a much greater ability to judge the value of government interventions. It is also giving more attention to outcomes.

The Labour/Alliance government has retained the cornerstones of the public management system, including the State Sector Act 1988, the Public Finance Act 1989, the State-Owned Enterprises Act 1986 and the Fiscal Responsibility Act 1994. There are indications that the government supports improvements to the accountability system suggested by the SSC and the Treasury.

It is understandable that a new government in power after nine years in opposition, with a heavy agenda for change to some policies, will be preoccupied with implementing these. In its desire to do this, the government has viewed advice critiquing these policies and their implementation problems as an impediment to change, rather than as a resource. This raises the risk of unexpected and unintended consequences. A public service that is able and willing to provide free and frank advice should be viewed as an asset. It is a concern that this public service commitment is under pressure from ministers and, that some senior officials are giving in to it. The state services commissioner has stated firmly that he stands for free and frank advice, but he may have to intervene with ministers and some senior officials at times to ensure that they stand with him on this policy.

It is 14 years since a government made the effort to have a full and thorough analysis and debate of the issues in public management at the core of the government. A vast body of public sector reform experience has

accumulated, but we are in danger of forgetting some of the reform lessons and, therefore, having to re-learn them. It is time to celebrate the best and deal to the rest. This requires attention to detail and to the facts in areas where sometimes insufficient evaluation and reflection has occurred and institutional memories are a little dim. It will require time, skill and energy. The creation of a board to monitor standards in the public sector provides a forum in which some of this evaluation might occur. The board has recommended to the government a 'Statement of Government Expectations of the State Sector'. This usefully adds new emphasis to a list of expectations that have been around for a long time. It breaks new ground, however, for an advisory body in signalling strongly its concern that the government, that is, ministers, must make strong commitments to improvement as well as the administrative organisations. To this end the statement includes a 'Statement of Commitment by the Government to the State Sector'.

It is accepted wisdom internationally that good government is critical to the economic and social welfare of a nation. New Zealand's own history shows this. The quality of public management is a key contributor to the quality of government as a whole. New Zealanders expect much from their governments and can realistically aspire to have a government that is as good as it gets anywhere. It is quite feasible for every public organisation to implement a strategy that puts it at the frontier of best practice and innovation internationally. Some already have.

New Zealand went through rapid change to its public management system in the 1980s, followed by some consolidation and improvement that occurred within a general pattern of drift where some gains were made and some problems remained. In the past three years, potentially far reaching improvements have been emerging in the public sector accountability arrangements. There are other management areas where the search for improvement must continue. But, along with designing new approaches and models, we must evaluate and learn from the rich lessons of experience. In some areas we appear not to be doing this and will surely have to re-learn those lessons.

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