Toward Better Government - Public Service Reform In New Zealand (1984-94) And Its Relevance To Canada
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Office of the
Auditor General of Canada

Acknowledgments

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As is usual in such circumstances, any errors remaining in the text are the sole responsibility of the authors.

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Foreword

Reform of public administration is now a worldwide phenomenon, as governments grapple with rapid social, economic and technological change, including the effects of globalization. Based on our view that much can be learned – by Canadians and by others facing similar challenges – from the sharing of reform ideas and experiences, my Office has been examining major initiatives undertaken in recent years in a number of relevant jurisdictions.

In 1993, we reported to Parliament on a study of public service reforms in Canada, New Zealand, Australia and the United Kingdom (Chapter 6 of the 1993 Annual Report). It gives me great pleasure to present in this publication a more detailed examination of reforms in New Zealand.

Over the last decade, governments of New Zealand have undertaken sweeping reforms of social and economic policies and of the public sector. Indeed, the magnitude of the change that has swept that country has led authoritative commentators to speak of a 'transformation" of New Zealand society.

Certain of their public service reforms are innovative efforts to solve long-standing dilemmas in public administration. As you read about what the New Zealanders have done, we hope you will agree that their approach is deserving of careful study and that certain aspects of it may well be worthy of adoption or adaptation to the government of Canada.

I would like to take this opportunity to personally express my thanks to all those who contributed to the development of this publication. The many individuals in New Zealand who set aside time to be interviewed by the Principal responsible for our study, and those who reviewed drafts of this paper, contributed a depth of knowledge and understanding of the New Zealand scene that was essential to the completion of our work.

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Introduction

In recent years, the Office of the Auditor General of Canada has been examining major public service reform initiatives in a number of jurisdictions that are relevant to Canada, with a view to fostering improvements in governance.

This study focusses on reform of the core public service in New Zealand. It examines the principal stages of a decade of reforms, including commercialization, corporatization and restructuring undertaken primarily over the period from 1984 to 1987, the fundamental changes in the approach to management and accountability, begun in 1988-89, and more recent initiatives which perpetuate and consolidate those reforms.

Our examination of reforms in New Zealand encompassed an extensive review of the literature, including official documents, together with briefings by, and discussions with, a former Secretary to the New Zealand Treasury, Dr. Graham C. Scott, and a series of interviews conducted in New Zealand with senior government officials and other knowledgeable individuals. The work has also benefited from the advice and suggestions of several reviewers, in New Zealand and elsewhere. Quotations from these sources are presented throughout this paper.

The paper begins with an outline of the context of public service reform: the institutional setting and the significant changes in New Zealand following an economic crisis in 1984. It then examines the various phases of reform, attempting to explain their origins and evolution and assessing progress to date. It concludes with a discussion of matters which, in our view, are of particular relevance to the government of Canada.

An Economy And Society In Transformation

About the County and Its People

New Zealand is an island nation in the South Pacific, roughly the size of the United Kingdom in area but sparsely populated, with 3.5 million people, and geographically remote from other countries (Australia lies almost 2,000 kilometres to the west, across the Tasman Sea).

The two major islands are North Island and South Island, stretching some 1,700 kilometres in combined length, but narrow across — no locality is more than 110 kilometres from the sea. The climate is temperate, and much of the terrain is mountainous, with the greater part of the agricultural land on North Island. A significant proportion of the population lives in cities, the largest being Auckland (820,000 inhabitants) and Wellington, the capital (323,000), both on North Island, and Christchurch (300,000) on South Island.

A former British colony and a member of the Commonwealth, New Zealand is a democratic nation with a parliamentary system of government. It is a unitary state, with a constitution similar to that of the United Kingdom.

New Zealand's discovery by Europeans (the Dutch) dates from the seventeenth century, although the country was not colonized until the early nineteenth century, by the British. A sizeable indigenous population, a Polynesian people known as the Maori, resisted the occupation of their land by the Europeans. The 1840 Treaty of Waitangi between the Maori and the British Crown pledged to the Maori people continued ownership of their land and other natural resources, but gave the Crown the right to govern. Wars over disputed lands continued until the 1860s. Today, the New Zealand government strives to honour the Treaty of Waitangi; a Waitangi Tribunal was set up in 1975 to adjudicate ownership rights and make recommendations to the government in that regard.

Although most of the population is of European origin, Maoris remain a significant minority in New Zealand society (about 11 percent of the population), and their culture is an important part of national life. In general, New Zealand is becoming progressively more multicultural, and Pacific Islanders also constitute an important single ethnic group (about 4 percent of the population).

New Zealand is not richly endowed with mineral or energy resources. The country's natural advantage lies in the production of pastoral products, especially from sheep farming, and in the growing of softwood lumber. The economy traditionally has been based on agriculture, which currently accounts for about 45 percent of export revenues. Processing of agricultural goods and other manufacturing date from the 1880s, and exports from this sector have shown significant growth in recent years, although in 1990 they accounted for only one quarter of export earnings. (OECD 1990: p. 33)

The rate of post-World War II economic growth has generally been slow. The country's major exports of meat, butter and wool were destined largely for the United Kingdom until it joined the European Community in 1973. New Zealand has experienced difficult times since then, attempting to diversify products and markets. Only since 1992 has its economic growth caught up with the Organization for Economic Co-operation and Development (OECD) average.

As the importance of trade with the United Kingdom has diminished, trade with Australia, Japan, the United States and the Middle East has grown. The Australia-New Zealand trading relationship has been stimulated by the 1983 Closer Economic Relations Trade Agreement, a simplified form of free trade accord (only 40 pages long) that basically removed all tariff barriers between the two countries.

Since the election of the first Labour government in 1935, political life in New Zealand has been dominated by two parties: the National Party and the Labour Party. The National Party, formed in the 1930s as a coalition of the Liberal Party and farming interests against the left-leaning policies of the Labour Party, is generally considered to be "middle of the road in ideological orientation. However, it should be noted that party ideology generally has played a less significant role in policy formulation in recent years. In the words of a former Secretary to the Treasury, Graham Scott, "New Zealand politics are driven by the practical necessity of meeting broadly agreed goals in a vulnerable and isolated economy."

From 1950 to 1984 the National Party was dominant, holding office in all but six years. The National government of Prime Minister Robert Muldoon, in power from 1975 to 1984, adopted policies that formed the context for reforms undertaken at a later date. Over this period, "government interventions and controls in the economy were more pervasive than in any other developed economy." (G. Scott 1994: p. 3)

A Labour government was elected in 1984, and re-elected in 1987 for a second three year term. From the start of Labour's mandate under Prime Minister David Lange, the government undertook extensive economic restructuring, including deregulation of some key sectors of the economy, sharp cuts in agricultural subsidies and in export assistance, and lowering of tariff barriers. There were also widespread changes in the public sector. In addition to the public service reforms that are the subject of this paper, the Labour government revamped the tax system, brought in a goods and services tax, undertook reforms in health and education, and gave the central bank increased autonomy to maintain price stability. It also privatized many public corporations.

In the 1990 election, Labour was defeated by the National Party. The National government, led by Prime Minister Jim Bolger, reviewed and retained public service management reforms and pursued other major reforms, in labour market regulation and in health, education and social welfare. In the November 1993 election, Mr. Bolger's National government retained power, with a slim majority of seats in Parliament. A feature of this election was the emergence of two relatively new parties, the Alliance and New Zealand First, each of which won two seats.

The Institutional Context

The System of Government

The Constitution of New Zealand, like that of the United Kingdom, is largely unwritten and is a mixture of statute and convention. The *Constitution* Act of 1986 patriated from British statutes constitutional legislation dating from 1852, and consolidated the essential provisions relating to the executive, legislature and judiciary.

The New Zealand system of parliamentary government, although similar to Canada's in important respects, is also substantially different. Like Canada, New Zealand is a constitutional monarchy, with a governor general acting in place of the British sovereign; the conventions of responsible Cabinet government also parallel those of Canada. However, New Zealand's unitary structure of government (there are no provinces), single legislative chamber and recent adoption of a form of proportional representation are major differences.

Parliament, under the *Constitution Act,* consists of the Sovereign in right of New Zealand and the House of Representatives.

The House of Representatives is elected by universal suffrage every three years. The three-year term, shorter than that of Canada's House of Commons, tends to concentrate the initiatives undertaken by each government in the first year or two of its mandate.

Although New Zealand traditionally followed a "first past the post" or simple plurality electoral system with single-member constituencies, a referendum held concurrent with the 1993 election resulted in a decision to adopt a modified form of proportional representation. It is based on a 120-seat House, increased from 99 seats. Under mixed-member proportional representation, electors have two votes the first vote for one of 60 constituency seats, and the second vote to determine the remaining seats and the party standings in the House of Representatives.

The introduction of mixed-member proportional representation is expected to facilitate a move from the two-party system, which has characterized New Zealand's political life for the last 50 years, to a multi-party political system. One consequence is that the simple transfer of power from one party to another may become more complicated, since elections might not deliver one clear "winner". To the extent that minority or coalition governments become the norm, this will have significant implications for the way Parliament, government and the public service operate, and will transform New Zealand's political culture, including the perceived "highly centralize nature of political power: "There are few effective checks and balances on the Executive [with] power.., concentrated in the hands of the Cabinet." (State Services Commission 1990: p. 2)

The responsibility for choosing the Cabinet is handled differently by the National and Labour parties. The National Party assigns the responsibility exclusively to the Prime Minister, as is done in Canada. However, the Labour Party's Cabinet selection involves both the parliamentary caucus and the Prime Minister; the ministers are elected by the whole caucus, and then the party leader (Prime Minister) allocates the portfolios among those selected.

Following the 1993 election, the Cabinet consisted of 20 ministers, responsible for 35 departments varying in size and importance; most ministers hold more than one portfolio. However, it should be noted that the government of New Zealand carries out many functions, in areas such as health and education, that in Canada are basically the responsibility of the provincial governments.

Among the institutions that act as a check on the executive are the Ombudsmen and the Controller and Auditor-General. [1] New Zealand was the first English-speaking nation to adopt the ombudsman concept from Scandinavia (in 1962). The statutory officers, namely the Chief Ombudsman and the Ombudsman, are independent officers of Parliament appointed by the Governor General on the unanimous recommendation of the House of Representatives. Although the Ombudsmen do not have executive authority, their powers allow for investigation of complaints and public reporting of findings to Parliament, with recommendations. Investigation and disclosure generally have been sufficient to bring about corrective action.

New Zealand has also enacted legislation on freedom of information and on privacy, comparable in some respects to equivalent measures in Canada. It has been noted that "anecdotal evidence from journalists and others suggests that New Zealand departments are [since passage of freedom of information legislation] more open in their day-today dealing with outsiders." (R. Hazell 1989: p. 209)

The Controller and Auditor-General, appointed head of the Audit Office by statute, reports to Parliament? A committee of the House of Representatives, the Officers of Parliament Committee "...considers and recommends the budgetary provision for the Audit Office and holds [the Controller and Auditor-General] to account for the management of those resources." (Controller and Auditor-General 1992-93: p. 17)

The Audit Office determines whether money was spent by the government in the manner authorized by Parliament, and it has powers to review the procedures of government agencies to see that resources "have been applied effectively and efficiently in a manner that is consistent with the applicable policy of the Government, agency or local authority." (Pub/it *Finance Act* (1977), section 25)

Local government in New Zealand is authorized and defined by parliamentary statute. Following extensive consolidation (625 government units were cut to 94) and other reforms in 1988-89, local

1. In New Zealand, as in other Western democracies, a range of other institutional arrangements also serve to limit the power of the executive government, such as the framework of laws and regulations that govern the management and financing of the state apparatus.

2. The legislation governing the Audit Office is under review; the government has announced that it will be amended in 1994-95 for a number of reasons, including recognition of the Controller and Auditor-General's status as an officer of Parliament and establishment of a seven-year term for the Controller and Auditor-General (at present the appointment is indeterminate).

government includes 13 regional councils responsible for resource management, parks, regional planning, etc.; 74 territorial authorities (for example, city or district councils); and 7 special purpose boards.

The Structure of the Public Service

The following points outline the present structure and institutional framework of the New Zealand public service. Exhibit 1 shows the organization of government, Exhibit 2 lists public service departments and numbers of staff (full-time equivalents), which totalled some 34,000 at 31 December 1993.[3]

(a) The basic pattern, common to Westminster systems, is a politically neutral public service, accountable to the political executive and open on a competitive basis to suitably qualified persons who are recruited and promoted on the basis of merit.

(b) **The organization, structure and functions of the public service are determined by legislation, namely the *State Sector Act (1988)* and the *Public Finance Act (1989)*.**

(c) At 31 December 1993, the public service was made up of three central departments and 32 other departments, divided between policy and operational functions. Under the *State Sector Act (1988)*, the public service includes the departments specified in the First Schedule to the Act (additions maybe made by Order in Council). These government departments are collectively referred to as the "core public service". The central departments are the Prime Minister and Cabinet, the Treasury, and the State Services Commission. In addition, the New Zealand Defence Force, the Police and the parliamentary agencies are funded directly from parliamentary appropriations, as area large number of Crown entities, including various boards and authorities.

From the perspective of financial reporting, the "Crown reporting entity" in the Financial Statements of the Government of New Zealand consists of the Offices of Parliament, departments, state-owned enterprises, Crown entities and the Reserve Bank of New Zealand.

3. Based on information provided by the State Services Commission. All public service staff figures after 1988 are expressed in full-time equivalents; prior to that time, staff numbers reflected numbers of employees. It should be noted that the listing of departments varies depending on the definition used.

Exhibit I
Organization *of Government*
37 **December *1993***

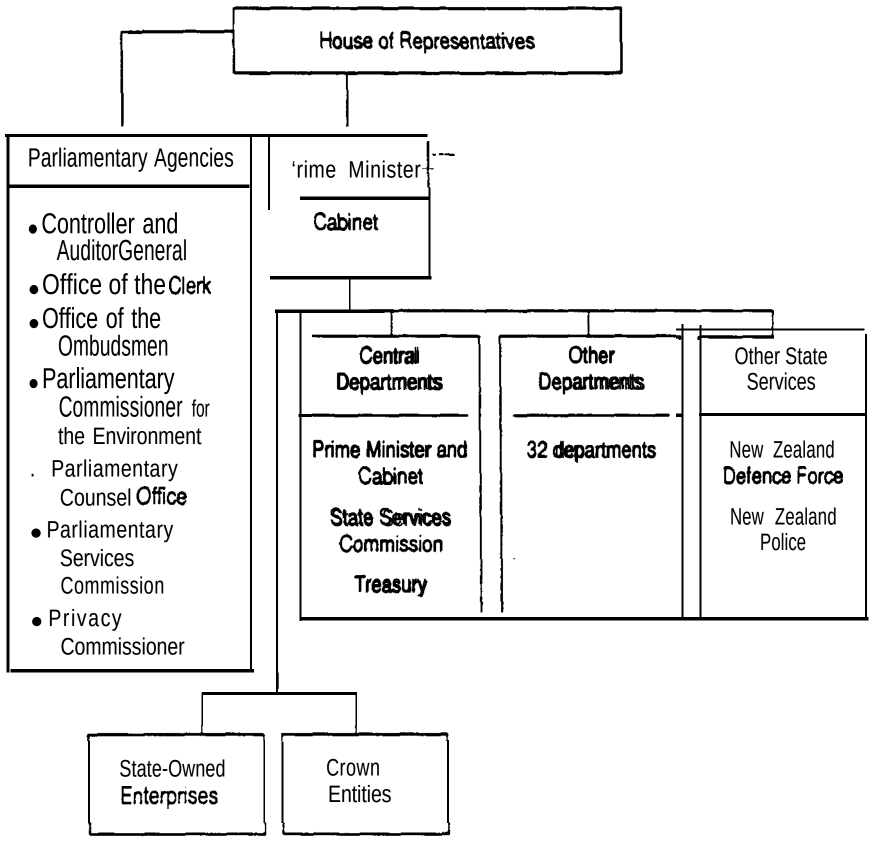

Exhibit 2
*Public Service **Departments** and Staff Numbers*
37 December 1993

DEPARTMENTS	STAFF NUMBERS (Full Time Equivalents)
Ministry of Agriculture and Fisheries	2,750
Ministry of Commerce	638
Department of Conservation	1,633
Crown Law Office	86
Ministry of Cultural Affairs	13
Customs Department	786
Ministry of Defence	53
Ministry of Education	466
Education Review Office	163
Ministry for the Environment	104
Ministry of Foreign Affairs and Trade	617
Ministry of Forestry	154
Government Superannuation Fund Department	55
Ministry of Health	367
Ministry of Housing	152
Inland Revenue Department	5,710
Department of Internal Affairs	1,532
Department of Justice	6,079
Department of Labour	1,762
Te Puni Kokiri (Ministry of Maori Development)	253
National library	444
Ministry of Pacific Island Affairs	38
Department of the Prime Minister and Cabinet	117
Public Trust Office	465
Ministry of Research, Science and Technology	30
Serious Fraud Office	36
Department of Social Welfare	6,927
State Services Commission	145
Statistics New Zealand	712
Department of Survey and Land Information	943
Ministry of Transport	49
The Treasury	364
Valuation New Zealand	433
Ministry of Women's Affairs	38
Ministry of Youth Affairs	23

(d) **The Department of the Prime Minister and Cabinet** was reorganized in 1989, combining the Cabinet Office with the advisory side of the Prime Minister's Office and leaving separate the Prime Minister's private office. The Department is responsible for ensuring interdepartmental co-ordination and co-operation, advising on government organization, supporting Cabinet committees, advising the Prime Minister on the government's goals and providing specific policy advice. At 31 December 1993 there were 117 full time equivalent staff.

(e) The Treasury advises the Minister of Finance and the Cabinet on fiscal policy, financial management, macroeconomics, and regulatory policies that have a major influence on economic performance. It consists of seven branches: social policy and government services; regulatory and tax policy; industries; budget management; financial management; the New Zealand Debt Management Office; and corporate services. **The Treasury has played the lead role in the design of public sector reforms and an important role in their implementation.** Since 1991, the Treasury has also prepared Crown financial statements on an accrual basis. The New Zealand Debt Management Office, established in 1986, manages the government's debt portfolio. The Treasury also advises on major social, trade and environmental issues. At 31 December 1993 there were 364 full time equivalent staff.

(f) The **State Services Commission** (SSC) is headed by two statutory officers – Commissioner and Deputy Commissioner — appointed by the Governor General in Council on the recommendation of the Prime Minister for a term not exceeding five years, and eligible for reappointment. As of 31 December 1993, these officers were supported by 145 full time equivalent staff. The Commission is responsible to the Minister of State Services for several functions, including policy advice on the design and management of government organizations, and personnel management, industrial relations and training services, provided on behalf of the Minister to chief executives of departments (akin to deputy ministers in Canada).

Among the Commission's management services is providing policy advice on the development, remuneration and other conditions of employment of senior public service managers, and on issues of management and performance within the public service. That activity has involved the "review of the efficiency, effectiveness, and economy of each department, including the discharge by the chief executive of his or her functions." (*State Sector Act* (1988)).

The Commission recommends to ministers the appointment of chief executives; it also enters into agreements with chief executives on conditions of employment, subject to approval by ministers.

Although the chief executives of departments determine the appointment, promotion, and conditions of employment of members of the Senior Executive Service, they also consult with the Commission in that regard.

Both the Commission and chief executives have statutory independence from ministers in decisions on individual employees.

(9) Chief executives are hired on contract to head government departments, and they sign performance agreements with their ministers that specify the targets they and their departments are expected to meet. The ***State Sector Act (1988)*** defines the duties of a chief executive as follows: carrying out the functions and duties of the department; tendering advice; the general conduct of the department; and the efficient, effective and economical management of the department's activities. The Act also requires chief executives to "operate a personnel policy that complies with the principle of being a good employer." Falling under that provision are working conditions, equal employment opportunity, appointment on merit and related matters.

Chief executives are accountable to ministers for the full range of departmental policies, priorities and the use of resources. Unless otherwise provided in the Act, they exercise "all the rights, duties and powers of an employer." Although the Act names the State Services Commission as the "employer party" for the purposes of negotiation with public service unions, in 1992 the Commission formally delegated this responsibility to chief executives.

(h) The major public service union is the Public Service Association. In 1987, public sector unions joined most of their private sector counterparts in one national umbrella organization, the New Zealand Council of Trade Unions.

New Zealand before 1984

From the late nineteenth century, the New Zealand government played an active role in developing and regulating the economy — a more active role than many other Western governments. It provided a wide range of goods and services and was instrumental in establishing and nurturing many leading industries (through, for example, considerable state ownership in the finance, energy, transport, agriculture and telecommunications sectors). In the finance sector alone, government involvement was massive, through outright ownership of the largest commercial and savings banks, the largest motor vehicle insurer, and the largest farm mortgage and residential lending institutions. It was also the owner of one of the largest merchant banks and controlled the boards of the biggest insurance and superannuation companies. By the early 1980s, the resources used by the public sector amounted to around 25 percent of Gross Domestic Product.

Following the Second World War and the wartime use of central planning to direct the economy, there developed a consensus that lasted well into the 1960s among major groups — farmers, manufacturers and workers – about their roles and entitlements. That consensus was sustained throughout almost 20 years of full employment, and a logical consequence was the continued willingness "for the government to act when matters were thought to need attention . . . to intervene whenever market actors were not producing desired outcomes." (P. McKinlay 1990: p. 11)

New Zealand developed an extensive social safety net. Public old-age pensions date from 1898; in 1938 the government introduced an extensive medicare system that included free hospital treatment, free pharmaceutical service and heavily subsidized medical treatment by doctors. Other prominent social benefits have included subsidized housing, free education through university level, as well as unemployment benefits and other social transfer payments.

From the 1960s to the 1980s, however, there was a notable decline in the performance of the New Zealand economy compared with those of other OECD countries. Per capita income grew just 1.4 percent per annum compared to 2.9 percent for the OECD as a whole (OECD 1993: p. 11). Over the same period, the Gross National Product per capita fell from fifth in the world to twentieth.

Although New Zealand, as an exporter of a small range of pastoral products, was particularly vulnerable to the uncertainties of international markets, including oil shocks (the dramatic price increases of the 1970s) and the United Kingdom's entry into the European Union, there is a widely held view that the policies designed to meet these external circumstances were themselves, over time, major factors in the poor performance of the New Zealand economy. The economic policies of the Muldoon government, from 1975 to 1984, have been characterized as "...a heavy reliance on particular forms of intervention in the economy... [that did] not achieve their objectives and frustrated the achievement of higher living standards." (The Treasury 1984: p. 106)

Through regulations, subsidies and taxes, the government had induced poor use of resources, low productivity and low growth. Very high tariffs and import controls provided high levels of assistance to domestic industry, which raised the cost structures of export industries. Extensive regulation of labour markets was tied to income distribution rather than to productivity. The tax system encouraged unproductive investments and burdened individuals with a high marginal tax rate (66 percent). As noted above, government-owned enterprise controlled a large portion of the economy; however, those enterprises suffered from poor management, low productivity and poor investment decisions. The level of service to the public was also poor; as a typical example, it took an average of six weeks for the state telephone monopoly to install a domestic telephone.

After the first oil shock, in 1973, economic growth virtually stopped for more than a decade.[4] The economic situation of the time has been described as follows:

> The government's response to the oil shocks was to borrow in order to increase subsidies to exporters and invest in energy development. Inflation surged upwards: the rate was 50 percent higher than the OECD average through most of the 1970s and 1980s...[the government implemented a 1982-84] freeze on all wages, prices, rents [and] interest rates. The economy languished, swamped by debt and regulation. Job losses continued to grow... [government spending] deficits blew out to 8.6 percent of gross domestic product in 1976-79 and 9.1 percent in 1963-64. (R. Douglas 1993: p. *24)*

Particularly difficult for New Zealanders was the rise in unemployment, which went from virtually zero in the 1960s to 130,000 (about 6 percent) by 1984. Although this rate of unemployment was not high in comparison with many other OECD countries, including Canada, it was a considerable shock to a people accustomed to full employment.

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4. The government decided in 1979-80 to develop energy "mega–projects" in partnership with the private sector, either by direct investment or by assuming the risk of private sector investment. This decision lad to heavy losses; in 1986 and 1987, the government was obliged to write off an estimated total of NZ S9.2 billion in associated debts. (C. James 1992: p. 65) (Note: the NZ dollar in Canadian terms has fluctuated since the 1980s — in early 1995 one NZ dollar was worth CAN S0.90.)

The 1984 Economic Crisis

Following amid-1 984 election campaign dominated by economic issues, the Muldoon government was defeated resoundingly at the polls. **The change of government precipitated an economic crisis that had been building for some time.** The immediate cause of the crisis was extensive speculation against the value of the New Zealand dollar in anticipation of a major devaluation following the change in government. New Zealand was forced to suspend foreign currency trading, having very nearly exhausted its reserves of foreign exchange; the country was in real danger of defaulting on its overseas borrowing. The situation was compounded by the very high level of government deficit and accumulated debt, which necessitated ongoing foreign financing.[5]

A major devaluation (20 percent) did indeed take place during the July 1984 transition of government, and in difficult political circumstances, because the outgoing Prime Minister was opposed to it. His disagreement led to a brief constitutional crisis, but his view was overturned by the urgency of the situation.

A significant underlying cause of the economic crisis was a decade of worsening trade balances. The exchange rate for the New Zealand dollar had been maintained around the 1972 level, despite a decline of approximately 30 percent in the country's terms of trade — that is, the quantity of exports that have to be sold to pay for a particular level of imports.

After 1984: *The Context for Public Service Reform*

The changes in economic policy brought **in by the Labour governments (1984-90) were so extensive that they were known collectively as "Rogernomics", after Sir Roger Douglas, the Minister of Finance from 1984-88.** The essence of Rogernomics was a return to the free play of market forces in the economy, stripping away the complex and comprehensive web of regulations and subsidies that had characterized the extensive government economic interventions of the past. To those enormous changes in economic policy was joined a vigorous program of social reforms. An understanding of the extent of those broader reforms helps to explain how the equally sweeping changes to the public service came about.

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5. A February 1984 International Monetary Fund report called the growth of the government deficit "a major imbalance in the economy that had become more serious [and] threatened to have a severe destabilizing effect on the economy." (cited in R. Douglas 1987p. 47)

Among the major economic initiatives of the Labour governments were:

- removal of all price, wage and income controls and foreign exchange controls (imposed by the previous government);
- elimination of controls on foreign investment, except for certain sensitive areas, such as coastal lands;
- removal of most subsidies to agriculture and industry;
- gradual reduction of tariffs, and acceleration of the trade agreement with Australia to implement full free trade;
- removal of a wide range of regulations in non-trade sectors, such as transport and energy;
- establishment of a more independent central bank (1 989 legislation gave the central bank increased autonomy to maintain price stability); and
- tax reform, including introduction of a goods and services tax (12.5 percent on all consumer goods and on services) simultaneously with a lower, flatter tax structure (a top rate of 33 percent) and a negative income tax for families (i.e., using the income tax system to deliver social assistance, with a guaranteed annual income). All tax expenditures were also eliminated.

As for social policies, Graham Scott has summarized the changes since 1984 as follows:

- A means test was applied to the universal government pension; prior to the means test, New Zealanders over the age of 60 received a pension of 80 percent of the average wage after tax, without regard to their level of income.
- In education, the governance of schools was transferred to parent-elected boards, and funding was based on a per capita formula.
- In housing, the bias toward state-owned housing for people qualifying for assistance was removed by creating a uniform amount of assistance based on need, which could be spent for either private or public housing.
- Welfare assistance for needy people was redesigned several times over the decade from 1984.
- Health care reform has been the most difficult area; there have been constant changes in policy since 1984. The core of the system is a decentralized network of regional health

> authorities whose task is to provide funding to government-owned and private providers of medical services. There is an arms-length relationship between the funders of health services and the providers, aimed at encouraging efficiency through competition and disclosure of performance information.

Another reform, implemented through the 1987 *Labour Relations Act,* affected labour relations in the private sector. The key features of the Act were: the freedom of the parties to determine which issues would be subject to negotiation; the removal of the unions' right to force employers into compulsory arbitration; and the elimination of a complex system of state wage-fixing tribunals.

Then, in 1991, the *Employment* Contracts Act gave employers and employees in both the private and public sectors "the freedom to choose with whom, and within what structures, they associate... contracts [are] for the parties themselves to determine". (OECD 1993: p. 56) The Act conferred greater bargaining freedom, accorded equal status to individual and collective employment contracts and removed all requirements for compulsory union membership.

Public Service Reforms

The Ideas behind the Labour Governments' Reforms

The major public service reforms that began in 1984 were integrally linked with the economic crisis and the conditions leading to it, as well as with political change — namely the election of the Labour government in 1984,

Although New Zealand did not base its approach to reform on a major long-term study or royal commission,[6] some noteworthy studies had been undertaken. In particular, the Controller and Auditor- General's 1978 report on financial management and control in government departments found serious deficiencies.[7] Thus, leading elements of the bureaucracy were aware of the need for change

> For at least two decades [before 1964] the Treasury, the State Services Commission, and the departments had been grappling with the problem of greater management accountability for the effective use of resources. Reforms had been sought in financial management, in information procedures, in the corporate planning of departmental programs, and in more explicit definition of the departmental mission. (J. Roberts 1987: p. 35)

Economic Management, the 1984 briefing document that the Treasury prepared for the incoming government, laid out several serious criticisms of the existing administrative regime:[8]

- Most departments had no clearly defined goals or management plan.
- There were few effective control mechanisms to review the performance of departments in meeting their required outputs.

6. J. Roberts (1 987: p. 34) noted: "No fundamental change in the organization of government administration occurred between 1912 and 1985...A royal commission, setup in 1961, found little evidence of bureaucratic ills... [This commission] in general simply endorsed the existing system."

7. Among the findings of this report (known as the Shailes Report): financial management was mediocre and lacked positive leadership; its focus of attention had been confined for too long to the narrow purpose of keeping expenditures within authorized levels; although many departments had significant semi-commercial activities, the potential for effective management of resources had not been realized; and approval systems were too rigid and complex, creating disincentives to good management.

8. *Economic Management* has been described as "a remarkable briefing document in which the Treasury analyzed the causes of New Zealand's economic malaise and prescribed policy directions..." (J. Martin 1992: p.2)

- Departmental managements had little freedom to change the way their departments operated to meet their goals, especially in staffing matters.
- Too much emphasis was placed on control of inputs.
- There were no effective review mechanisms for dealing with poor performance by senior management.

When the Labour government took office in 1984, it had been in Opposition for some time, and felt little sense of obligation to the existing institutional arrangements, including the structure of the public service. The post-election Cabinet was, in the words of one of its former members, the Hon. David Caygill, "more economically literate than its predecessor." In addition, as a government official (Lesley Adcock) noted, "The new government . . . was effectively a generation younger than the one that had left . . . [it was] very deeply committed to making fundamental change come about."

As they acquired experience in government, ministers in the Labour Cabinet became increasingly frustrated with weaknesses in the public service — its inability to deliver policy outcomes and the cumbersome nature of much of its apparatus. [n particular, the system of incentives operating in the bureaucratic machine was perceived as unsatisfactory. An important force behind public service reform was the effort made to overhaul the inner workings of government by several key ministers.

In support of ministers, the Treasury played a key role in developing a theoretical framework for public service reforms, making extensive use of economic and management theory, Six theoretical elements have been identified: agency; public choice; contracting; finance; accounting; and management. The Treasury articulated the policy implications of the theories at appropriate moments in the genesis and implementation of reform. That analytical base allowed coherent, consistent solutions to problems in public service management to be put forward as the government dealt with the economic crisis and undertook major economic and social change. A brief discussion follows of two of the less well-known theories, agency and public choice.

Agency theory deals with relationships in the public service in terms of various kinds of agreements or contracts between "principals" and "agents". The theory grapples with the problem of ensuring that agents serve principals in accordance with stated or implied contractual conditions. The essential policy prescription is to clarify and define the relationships between ministers and top officials, and between the latter and departmental managers at lower levels.

An important application of that theory was the replacement of permanent heads of departments by chief executives, a reform brought in by the *State Sector Act (1988).* Permanent heads, appointed by a group of their peers, had tended to remain in office until retirement, and there was no legal provision for assessing their performance. Chief executives, in contrast, are hired on contract, with performance expectations laid out in written agreements with ministers. They face a regime of rewards and penalties that, "in terms of agency theory, focusses on the incentives of a key agent, who can affect the incentives and thus the performance of other agents in the organization." (G. Scott, P. Gorringe, 1989: p. 83)

Public choice theory, in turn, helps to identify and respond to perceived problems such as bureaucratic empire-building. One implication of this theory is that public officials tend to behave in self-interested ways by maximizing rewards, including an increase in the size and power of their organizations.[9] In policy terms, the theory suggests that bureaucratic structures and behaviour within those structures need to be re-examined to ensure that individuals serve the public interest.

Both agency and public choice theories recognize that incentives are an important means of changing bureaucratic behaviour. Appropriate incentives maybe personal, such as performance pay (positive) or termination for non-performance (negative); or organizational, such as financial measures designed to ensure sound management of assets. Such incentives may help to ensure that contractual agreements are fulfilled and that self-interest is channeled productively. Attention to incentives has been a recurring theme of New Zealand reforms.

Decentralization and Commercialization

Two early areas of reform were decentralization of decision making, and commercialization. These measures were undertaken, for the most part, over the period from 1984 to 1987.

The new Labour administration emphasized greater managerial discretion over inputs, including staffing, as a means of improving the efficiency, adaptability and responsiveness of the public

9. James Buchanan, one of the founders of public choice theory, expressed its central idea: "...that people should be treated as rational utility-maximizers in all of their behaviourial capacities... and that institutions must be designed so that individual behaviour will further the interests of the group." (Cited in John Martin 1988: p. 10)

service. Senior managers were given greater control over resources, e.g., discretion to adjust staffing levels, and efforts were made to delegate authority to managers "to the lowest level of competency" (J. Boston 1987: p. 434), although the extent of such delegation has varied among departments.

In mid-1986, an exercise known as "Removal of Constraints" streamlined the rule books. The State Services Commission removed a lot of its controls over day-today management of departments, including matters such as salary fixing, job classification, hiring and firing of staff and other aspects of personnel management. Such measures resulted in the deletion of some 95 percent of the 2,000 or so detailed instructions contained in the Public Service Manual (the code governing conditions of employment), which was later abolished.

Commercialization involved the adoption by government departments of a "set of operating guidelines based on financial criteria". The objective was to "emulate a commercial management environment in the provision of services [where appropriate to do so] with cost-effectiveness and competition as the driving force." (A. Kouzmin et al. 1990: p. 86)

Commercialization formed apart of a concerted effort by the government, from 1984 on, to cut public spending and reduce the deficit. In 1986, the Minister of Finance set forward economic principles "requiring all government agencies to realize the full potential for profitable trading":

- Where functions of departments were removed or reduced, funding would be reduced accordingly.
- Departments would be given strong incentives to raise revenues to fund their activities.
- Departments would be required to recover costs from users.
- Incentives would be put in place to improve departmental asset management.
- overall funding reductions would be used where necessary to improve departmental efficiency.

Corporatization

The ideas behind corporatization gelled in 1985, early in Labour's first term. **The thrust was to reorganize New Zealand's public service by separating commercial from non-commercial activities and constituting state-owned enterprises (SOEs) to carry on the commercially oriented activities.** The necessary legislation was enacted in 1986, and the first of these new enterprises came into existence on 1 April 1987.

Before corporatization, the public sector in New Zealand included departments with commercial functions as well as commercial public corporations. Government departments delivered services often provided in other countries by private (or public) enterprise. Thus, the Department of Energy was responsible for both coal and electricity production, and the Forest Service was involved in the commercial production of forest products; the Post Office ran the telephone system and a bank as well as postal operations.

The origins of state-owned enterprises were tied to financial non-performance,[10] the underlying causes of which were a lack of clear objectives and poor management systems. Government ministers were unable to effectively exercise financial control overstate trading organizations using conventional methods of ministerial responsibility. Information systems were inadequate, "designed to help the government ration the [allocation] of annual resources, not measure the value of what [was] produced." (R. Douglas 1993: p. 177)

The legislative instrument for corporatization was the *State-Owned Enterprises Act (1986)*; the minister responsible described its purpose as follows:

> ...the government has decided to establish state-owned corporations which will takeover major areas of state trading activities and be run as profitable operations. State tradingactivities need greater freedom from bureaucratic controls, greater clarity of objectives, sorting out of conflicting roles, and more streamlined structure-s. (cited in S. Lojkine 1992: p. 34)

There were three broad objectives in creating SOEs:

- to separate commercial and non-commercial activities, with clear commercial objectives for SOE boards and management and government funding for noncommercial activities;

10. In the 1986 Statement on Government Expenditure Reform, it was estimated that the net after-tax cash return to the taxpayer that year on NZ S20 billion in assets of government-owned corporations would be zero (in an economy with a Gross Domestic Product of NZ $45 billion at the time).

- to implement "competitive neutrality", defined as follows "as far as possible, all competitive advantages and disadvantages arising from statutes should be removed" (G. Scott et al. 1990: p. 145); and
- to provide incentives for management to perform well, which included "arm's length" accountability to the political executive and Parliament.

Thus, **SOES were setup with a capital structure relevant to their industrial sectors, and were required to pay taxes and earn a competitive rate of return on equity. There was a program of deregulation: virtually all statutory monopolies enjoyed by SOES were removed, exposing them to open competition from the private sector.** For example, one of the SOES formed from the former Post Office Department, Telecom Corporation of New Zealand, saw the end of its monopoly on the supply of telephone equipment and services; moreover, within a year or two, the national telephone network was deregulated.

The funding arrangements for noncommercial activities were made transparent, with formal agreements between the government and the SOE that specified the goods and services to be subsidized.[11]

The changes in accountability were based on ministerial responsibility for broad policy objectives – and ministerial approval of the strategy for achieving them — and SOE management independence "to get on with the job with minimum political interference." The main features of the accountability system were outlined as follows:

- establishment of specific objectives and performance measures for each SOE, in consultation with ministers;
- performance objectives and plans (and targets) made public at the beginning of the reporting period (SOEs provide this information through Statements of Corporate Intent, which are tabled in the House of Representatives and maybe examined by committees of the House);
- regular reporting of actual performance against targets, with monitoring of SOE performance by the Treasury and appropriate government departments. That monitoring

11. Examples of commercially non-viable services delivered by SOEs on the basis of explicit contracts with the government included banking and postal facilities in low-volume locations, local or rural telephone services, urban passenger rail services and the universal postal service. (G. Scott et al. 1990: p. 147)

is carried out through reviews of longer-term strategy, annual operating plans (the Statements of Corporate Intent) and quarterly results; and

- new incentives (and sanctions) for senior managers, such as performance pay.

(J. Boston 1987: p. 435)

The initial wave of SOES covered the vast bulk of government commercial activities. Although other SOES are being set up, for example, the Meteorological Service in July 1992, they are in areas that are less clearly commercial. Exhibit 3 shows the five government corporations that existed before corporatization, the SOES created from 1987 to 1989, and the list of SOES as of 30 June 1994. As with the commercial operations of departments, the pre-existent public sector corporations had performed poorly; for example, the Shipping Corporation had a history of projecting profits in the face of chronic losses. Those corporations were subsequently treated as though they were SOEs.

> *Two banners under which state sector and SOE reforms took place were greater efficiency and enhanced accountability. On the efficiency side, it has bean very successful. SOES were so successful that they became a model for what was done in the core public sector. /n terms of accountability, the financial information is better...*
>
> – John Martin (Victoria University)

The SOE policy met with considerable financial success. Studies carried out by the New Zealand Institute of Economic Research show that, across seven of the larger SOES, revenue rose by 15 percent between 1988 and 1992, and after-tax profits quadrupled from NZ $262 million to NZ $1.023 billion. Those financial gains were accompanied by significant staff reductions: from 1987 to 1992, staff numbers in the same seven SOES declined by 53 percent. Three examples of individual SOE performance (from R. Douglas 1993: p. 180) illustrate the point further:

- The Post Office Savings Bank, in its first year as an SOE, cut staff by 30 percent, reduced its retail outlets by 40 percent and turned an expected loss of NZ $50 million into a NZ $31 million profit.

- In six months, the new Forestry Corporation achieved a NZ $59 million turnaround; it returned a cash surplus of NZ $24 million, compared to a cash deficit of NZ $35 million

Exhibit 3
State-Owned** Enterprises **(SOEs)

Existing Corporations - 1 April 1987	SOEs as of 30 June 1994
Air New Zealand Limited New Zealand Railways Corporation Petroleum Corporation of New Zealand Limited Tourist Hotel Corporation of New Zealand The Shipping Corporation of New Zealand Limited	Airways Corporation of New Zealand Limited Coal Corporation of New Zealand Limited Electricity Corporation of New Zealand Limited Forestry Corporation of New Zealand Limited GCS limited Government Property Services Limited Land Corporation Limited Meteorological Service of New Zealand Limited New Zealand Post Limited New Zealand Railways Corporation Radio New Zealand Limited Television New Zealand Limited Timberlands West Coast Limited Vehicle Testing NZ Limited Works and Development Services Corporation (NZ) Limited
SOEs Established from 1987 to 1989 **Created - 1 April** 1987 Airways Corporation of New Zealand Limited Coal Corporation of New Zealand Limited Electricity Corporation of New Zealand Limited Government Property Services Limited Land Corporation Limited New Zealand Forestry Corporation Limited New Zealand Post Limited Post Office Bank Limited Telecom Corporation of New Zealand Limited **Created - 1** April 1988 Works and Development Services Corporation (NZ) Limited **Created - 29 November** 1988 Radio New Zealand limited Television New Zealand Limited **Created - 19 December** 19S9 New Zealand Liquid Fuels Investment Limited	

recorded in the six months before becoming an SOE. Within 12 months, the number of employees had been cut from 7,000 to 2,600, without loss of output.

- New Zealand Post reduced its staff by 30 percent in its first four years as an SOE; since corporatization it has putNZ$190 million back into the public purse through tax and dividend payments to the government.

There is also some evidence that customers have benefited from the SOE policy. For example, in the case of Telecom Corporation, prices to consumers fell by 20 percent, and the average waiting time for a telephone was reduced from 6 weeks to two days. For electricity and coal, delivered by SOES, prices have also fallen significantly.

Beginning in the second term of Labour government, 198740, and continuing since then under the National government a large proportion of state-owned corporate assets has been privatized, including: Petroleum Corporation, the Post Office Bank, Air New Zealand, Shipping Corporation and Telecom Corporation. In the minds of many, SOES area "halfway house" to privatization, although this was not the disclosed policy of the Labour government when the legislation was enacted or during the 1987 election campaign. As of 30 June 1993, there had been a total of 25 business or asset disposals, worth NZ $13 billion; the remaining equity in SOES, recorded in the Financial Statements of the Government for that year, amounted to NZ $7 billion.

Restructuring

The success of corporatization led to the application of many of the same ideas to the remaining government departments. In its 1987 brief to the incoming government, titled Government Management, the Treasury called for structural reforms based on the need for clarity of objectives:

> Greater clarity of objectives is the key principle which must underlie any reform if management is to be improved: structural reforms are an important step in achieving this. One such reform would be the separation, in different agencies, of responsibility for provision of policy advice regulatory and funding activities, and operational activity... [which] would enable the objectives of management to be specified a great deal more clearly than occurs at present and would enable the performance of agencies to be more readily assessed. (p. 76)

The Treasury also pointed out that the separation of policy advice from operational functions would allow those responsible for operational activities to "have as their prime objective running their operations as efficiently as possible given the policy parameters established by the Government." That approach would also avoid "producer capture": we were told that there had been a serious problem of policy advice tending to serve specific interests (that is, being "captured) rather than the broader public interest.

Structural reforms based on these ideas started in the period before the 1987 election, as the State Services Commission and the Treasury worked on an agenda for structural reorganization of government administration, and the reforms continued apace thereafter.

The environmental sector illustrates the separating out of policy and operations, including commercial activities, and the consequent restructuring of the public service. The previous New Zealand Forest Service and Department of Lands and Survey both had a mixture of policy, regulatory, service delivery and commercial functions. Three new departments were created to handle these functions: the Ministry of the Environment (policy advice), the Ministry of Forestry (policy, regulatory and service delivery) and the Department of Survey and Land Information (service delivery). At the same time, two SOES were created to carry on commercial operations: Forestry Corporation and Land Corporation.

Other examples of the separation of policy from operations are provided by the reorganizations of many departments, including transport, education, health, science and defence.[12] In defence, a small, policy-focussed Ministry of Defence (53 staff as of 31 December 1993) was established as an entity separate from the operational New Zealand Defence Force.

Exhibit *4* shows the restructuring of the transportation sector, with a small Ministry of Transport providing core policy services, and five Crown entities with regulatory or operational functions.

> ***In terms of the [separation of] policy from operations... we try to structure in a way that there is transparency [about objectives and performance] between the peeple providing the money and [those] delivering on the objectives The emphasis is on performance specification before-the-fact.***
>
> – Graham Scott

Crown entities have been used widely in departmental restructuring; the term "Crown entity" dates from 1992 legislation, which regularized the financing and accountability arrangements for the numerous entities that were neither line departments nor SOEs. The

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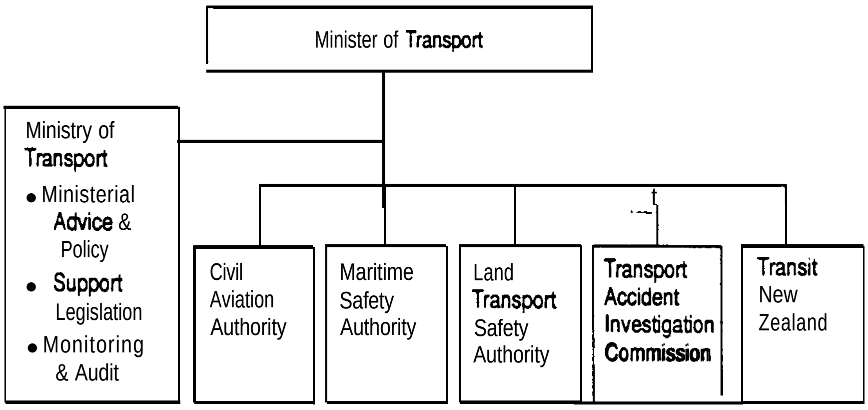
12. In 1993, on its own initiative, the Audit Office also separated policy from operations by reorganizing into two units: the Office of the Controller and Auditor-General (52 staff) and Audit 'New Zealand (296 staff). The former is responsible for: "policy, standard-setting and oversight of the provision of audit services, together with Parliamentary reporting and liaison." The latter "...performs the operational audit functions... for a sub stantial part of the portfolio, in competition with other [private sector] potential providers of audit services." (Controller and Auditor General 1992-93: p. 7)

Exhibit 4
*Restructuring of the **Transport** Sector*



Note: The Civil Aviation, Maritime Safety and Land Transport Safety Authorities are responsible for safety rules, licensing and standards enforcement, in their respective areas. The Transport Accident Investigation Commission conducts independent investigations of major transport accidents. Transit New Zealand is responsible for road infrastructure management and funding.

entities have been assigned regulatory, purchasing, service delivery and other operational functions. Closely resembling them are Crown Research Institutes (CRIs), established in mid-1992 from the existing government science departments; CRIs are charged with establishing research capabilities and carrying out scientific and technological services. Most of these entities are run by autonomous boards, which appoint their chief executives (who are vested with powers comparable to those of departmental chief executives), Crown entities operate under "statements of intent", formulated with the agreement of the responsible minister, and tabled in Parliament. These statements specify objectives, performance targets and measures, accounting practices and other performance and accountability provisions. (State Services Commission 1994: p. 8)

The impact of corporatization and restructuring on the size of the public service was substantial: from 53 departments and agencies with approximately 86,000 staff in mid-1 984 (126,000 if the Post Office is added), the public service was reduced, by 31 December 1993, to 35 departments and 34,000 full time equivalent staff, The steep decline in staff numbers was due in large part to the transfer (by 1988) of some 23,000 public servants to state-owned enterprises. Other public servants were transferred to Crown entities. A substantial number of core public service jobs were also eliminated through downsizing, reorganization and rationalization, or, in some cases, direct privatization of departments. Examples of the latter are Government Life Insurance and Government Printing, which were privatized without first becoming SOES. Examples of departments merged are Tourist and Publicity, which was made part of Commerce (itself based on the Industry side of the former Department of Trade and Industry), and Trade, which was merged with the Ministry of Foreign Affairs to form the Ministry of Foreign Affairs and Trade. An example of the implementation of cutbacks is provided by the Department of Labour, which eliminated three of every four of its management jobs. As the State Services Commission put it in a 1994 paper: "the reforms did bring an end to [public sector] careers for a very significant number of people." Another perspective on the significance of the cutbacks is reflected in the following quotation of a former senior Treasury official (Andrew Weeks):

> Railways had 25,000 people in their job creation schemes...it was disguised unemployment. Forestry had the same. We have changed that; if we have 100,000 people tucked away in state jobs and non-jobs, we do not have real full employment...We have unprecedented levels of unemployment... but the level is pretty normal for a Western nation.

Fundamental Revision of Management Structures - The State Sector Act (1988)

Following Labour's re-election in 1987, the theme of greater efficiency in government – embodied in corporatization and related initiatives — together with a willingness to apply economic theories and new policies, led to fundamental revision of the legislation governing the public service.

The 1966 *State Sector Act* extensively amended the 1962 Act and replaced the *State Services Conditions of Employment Act (1977).* Under the earlier legislation, the public service was uniform and unified, with a service-wide classification (grading) system. There was a career service, offering employees a 40-year career if they so desired, with tenure. Public servants moved among departments and enjoyed a standard set of working conditions and rates of pay. Appointments and promotions, although based on a merit principle, were seen by many to be constrained by personnel management conventions, supported by an appeal authority. We were told that the number of years on the job was a significant determinant of "merit", and that this was upheld by the appeals tribunal. It was difficult for outsiders to be appointed to the public service; they needed to demonstrate "clearly more merit" than insiders.

Traditionally, the State Services Commission had exercised strong central control over the public service, Its powers extended from the management of office accommodation to the review of efficiency and economy in each department, as well as ultimate authority in personnel matters.

Despite the measures taken between 1984 and 1987 to give departmental managers more authority, the centralized system continued to be the subject of much criticism. The then Deputy Prime Minister, writing in 1987, described it as follows:

> The manner in which the appointment, promotion and pay setting systems work tends to be cumbersome and inflexible. The management systems... budgetary and staff control, also tend to be rigid and overly centralized. (G. Palmer 1987: p. 82)

An example of the problems was the public service appeal system, which under the 1962 Act was seen to holdup appointments for a long time, to make no effective contribution to good management, and to be based on a set of criteria that were extremely difficult to apply.

Provisions of the Act

The 1988 *State Sector Act* made major changes in the management, personnel and labour relations regimes in the public service[13]. Among the key reforms were the following:

- **Chief executives now are appointed to head departments for a fixed term, under contract with the State Services Commission** (terms are limited to five years; in practice, most incumbents have been reappointed for three years). They replaced "permanent heads", the former tenured officials in charge of departments, who had been appointed by a committee of senior officials, under the auspices of the State Services Commission.
- The process provides for ministers to inform the Commission of the government's requirements for each chief executive position. Chief executive appointments are

13. Lengthy discussions with public service unions had preceded the introduction of this legislation. However, these discussions failed to produce the concessions that key ministers saw as necessary.

approved by Cabinet, based on the Commission's recommendation.[14] The Cabinet may decline the recommendation, in which case it may direct the Commission to appoint a named person to the position, but notice of a Cabinet-directed appointment must be published in the official *Gazette.* A 1990 amendment to the Act allows the Commissioner to forma panel to advise on potential appointees.

- Chief executives are accorded responsibility in law for the effective and efficient operation of departments.
- The State Services Commission may undertake departmental reviews "of the efficiency, effectiveness and economy of each department, including the discharge by the chief executive of his or her functions." Departmental reviews, which have been scaled down in recent years, are carried on separately from annual reviews of chief executive performance. The findings of the reviews of chief executives are reported to the ministers responsible for their departments. With the agreement of Cabinet, the Commission is empowered to remove a chief executive from office "for just cause or excuse".
- **As a result of the 1988 *State Sector Act*, labour relations in the public service are no longer subject to legislative provisions entirely separate from those applying to the private sector, i.e.,** the *Labour Relations Act (1987)* and subsequent labour legislation, notably the Employment Contracts Act *(1991).* The public service became subject to the Arbitration Commission, to resolve disputes in the negotiation of agreements, and the Labour Court, to interpret existing agreements. Both of these bodies (which were replaced in 1991 under the *Employment Contracts Act* by the Employment Tribunal and the Employment Court,[15] respectively) previously had jurisdiction only in the private sector.
- The State Services Commission is named in the 1988 *State Sector Act* as the "employer party" for the negotiation of conditions of employment, including remuneration, with the public service unions. However, in 1992, using its powers of delegation in the Act, the Commission assigned this employer role to chief executives.

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14. This is a notable difference from the practice in Canada and other countries, such as the United Kingdom and Australia, where the Prime Minister decides these appointments.
15. The Employment Tribunal mediates between employers and employees and adjudicates on matters concerning employment contracts (grievances, disputed interpretation of contracts, etc.); any appeal of a Tribunal decision is made to the Employment Court.

- **With the exception of the authorities given in the Act to other parties, chief executives are accorded "all the rights, duties, and powers of an employer" with respect to the employees of their departments.** Thus, chief executives may appoint "such employees [as they] think necessary for the efficient [operation of their department]"; and, subject to agreed conditions of employment, they may also remove employees "at any time". Chief executives are also designated as the "employer party" in the case of personal grievances of employees, or in the case of a dispute involving the rights of employees, although, for the latter, chief executives may be required by the Commission to act in consultation with it.
- In respect of personnel policy, the chief executive is required to be a "good employer", which includes adherence to the merit principle in all appointments (the Act states: "the chief executive...shall give preference to the person who is best suited to the position") and development of an equal opportunities program.
- The requirement to be a good employer has led departments to establish internal procedures for appeal against management's personnel decisions. These appeals are in the first instance to the chief executive, who might, for example, establish an independent panel to review a decision. All decisions are ultimately subject to review by the Employment Court, to which a complaint can be brought on the same grounds as in the private sector.
- A Senior Executive Service (SES) was established under the auspices of the State Services Commission to develop a core group of senior public service executives.
- Chief executives, in consultation with the State Services Commission, make appointments to SES positions on the basis of merit, for terms not exceeding five years (with eligibility for reappointment), and set conditions of service.

One effect of the reforms has been the loss of guaranteed tenure for public servants. There are, however, differences in job security (given satisfactory performance) depending on the level of the position involved. Employment contracts at more senior levels tend to be job-specific; for other levels of employees these contracts are more general, allowing for significant changes in duties without jeopardizing job security.'[6]

Ministers and Chief Executives

At the heart of the reforms is the role of the chief executive. The Labour government sought greater responsiveness from senior public servants than it believed had been possible under the former tenured arrangements. The reforms created a relationship between ministers and deputy heads of departments that is different from those in other Westminster systems by virtue of the method of appointment of deputy heads and the performance-related contractual framework, although there are some parallels with reforms in the United Kingdom and Australia.[17] Only in New Zealand are deputy heads both employed on fixed term contracts and subject to the kind of performance and accountability arrangements that now exist. Ministers remain accountable to Parliament, in conformity with the principle of ministerial responsibility. The chief executive of each department is considered to act as the agent of ministers, and signs a performance agreement with the "responsible" minister (the minister who, in consultation with other ministers associated with the department, executes the performance agreement) .18 Performance agreements (to be discussed later) form the basis for the accountability relationship between ministers and chief executives.[19]

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16. Employment Court decisions have been interpreted as supporting employee contract renewal where performance has been satisfactory and the job has not changed.
17. The United Kingdom government proposed in mid-1 994 to introduce contracts of employment for permanent secretaries and other senior civil servants, with indefinite terms but specified periods of notice; and chief executives of Next Steps agencies within departments have a "quasi-contractual" relationship with the minister, defined by the agency framework document. In Australia, 1994 legislation made provision for five-year contracts for secretaries of departments.
18. Subsequent legislation, the Pub/it *Finance Amendment Act (1994)*, defined the responsible minister as meaning "in relation to a department, the ministers] for the time being responsible for [its] financial performance."
19. Chief executives and other senior officials, rather than ministers, generally appear before committees of the House of Representatives, which constitute the "working level" of parliamentary scrutiny. The Clerk of the House of Representatives has noted "[senior] officials speak to committees for ministers...[and are expected] to deal with policy questions...committees examine ministers from time to time but this is no substitute for the ability to refer to an official for an explanation." (D. McGee 1991: p. 55)

> ***The objective was to create contracts between chief executives and ministers which are efficient [and] align the interests of the chief executive [with] the interests of the government [as expressed in] its strategy. That is the touchstone [of the model].***
>
> – Graham Scott

The annual performance agreement is separate from the multi-year contract of employment between the chief executive and the State *Services* Commission (although the employment contract places certain performance requirements on the chief executive that are given effect through the performance agreement). The State Services Commission, as employer of the chief executive, gives "considerable weight . . . to the evaluations provided by portfolio ministers" in undertaking its annual performance assessments. (J. Boston 1992: p. 420) Part of chief executives' salaries may be based on performance.[20]

The new system may also be seen to require more from ministers than the old one did. Ministers must be in a position to know what they want, and to articulate it, so that they can negotiate performance agreements with their chief executives.

The Senior Executive **Service**

The Senior Executive Service was intended, as stated in the Act, "to constitute a unifying force at the most senior levels of the public service". Many of the 1988 reforms are seen as decentralizing the public service; in contrast, the SES is managed jointly by the State Services Commission and individual chief executives. Chief executives, in consultation with the Commission, make

20. The usual pattern for chief executive salaries is for new appointees to receive around 95 percent of their base salary, with increases beyond this (up to a maximum of either 110 percent of base salary or NZ S1 0,000) determined on the basis of performance. One survey, covering the 1988-91 period, found that the average remuneration (including non-cash benefits) of chief executives had fallen significantly behind their private sector counterparts (J. Boston 1992: p.411). Our understanding is that the salaries of chief executives moved toward private sector rates immediately following the 1988 reforms; however, the government's subsequent reluctance to allow raises has caused the salary gap, on average, to widen again.

appointments to SES positions and establish terms and conditions of SES contracts. These contracts may not exceed five years in duration, but maybe renewed at the discretion of the chief executive; there is a reasonable expectation of ongoing contract renewal, provided that performance has been satisfactory. The Commission also has responsibilities under the Act for the development of the SES to ensure "ability and integrity", and for ongoing training, and exercises this role in consultation with chief executives.

The concept of the SES is not supported fully by all government departments. Many senior staff are not drawn from the SES, but are retained on personal service contracts with the chief executives of their departments. Although the Act allows for the appointment of up to 500 SES staff, the 1992-93 Report of the State Services Commission identified 347 public service staff in the SES salary range, of whom only about 150 were members of the SES. In the spring of 1993, Graham Scott informed us that:

> ...the SES is considered to have failed...part of its problem was that it was used as an instrument of wage control...many senior public servants just did not see any merit in the idea [of the SES] and ignored it. There is some evidence that staff in smaller departments outside Wellington found more value in the concept as a means of communicating with their peers.

The view that the SES had failed is also apparent in an earlier annual report of the State Services Commission (1990-91), in which the Commissioner noted:

> ...the experience of the (SES) has not realised the promise it offered...the "unifying force" has not emerged and senior officials do not see themselves as part of a professional corps of management...

Employer-Employee Relations

Labour relations in the public service have been changed significantly by the *State Sector Act (1988)*; later legislation, the Employment *Contracts Act* (1991), has also had an impact. The

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21. Following a 1989 amendment to the *State Sector Act*, there are two ways for individuals to join the SES: by being hired to fill a designated SES position or by "personal declaration". With the latter, the Commissioner of the State Services Commission, acting on the joint recommendation of an SES member and an independent selection panel of chief executives (including one from the private sector), can declare a qualified public servant to be a member of the SES. Such a declaration is made with the concurrence of the chief executive of the department involved. The rationale for using personal declarations for appointments to the SES is that, in some situations, people should belong to the SES by virtue of their personal competency rather than because of the position they hold.

wage-fixing system in the public service before 1988 was based on a centrally negotiated "annual general adjustment" to pay rates, and a system of service-wide pay rates and scales applied to some 200 employee occupational classifications.

In important respects, the 1988 Act made chief executives the employer, and set out requirements in terms of the merit principle and other "good employer" provisions, The State Services Commission then (in 1992) delegated collective bargaining authority to chief executives, replacing the previous system of centrally determined pay and conditions.

Occupational classes were rationalized: for example, the Ministry of External Relations and Trade has reduced the number of classifications from 16 to two, and in 1993 the Ministry of Agriculture and Fisheries had only four. (State Services Commission 1993: p. 14)

When chief executives of departments negotiate with the unions, they do so on the basis of prior consultations with the State Services Commission, to give them a common "background to the wage round".[22] The location of an individual in a salary range is dependent on performance, and chief executives and managers have discretion in where they place individuals within the range. Departments may also pay bonuses to staff if they wish.

Between 1988 and 1991, senior positions were excluded from collective bargaining as union coverage became a negotiable issue (this practice varied from department to department — State Services Commission 1993: p. 14). Following passage of the 1991 *Employment Contracts Act,* the individual contracts of managerial staff, including the chief executive, fell within the jurisdiction of the Employment Tribunal and Employment Court, and standard dispute settlement and grievance procedures applied, unless modified by agreement between the parties. This Act, as noted earlier, reformed the labour market in New Zealand, according equal status to individual and collective employment contracts[23] and removing all requirements for compulsory union membership. Its impact was greater in the private sector than in the public sector, since the *State Sector Act (1988)* had already covered much of this ground, notably with respect to individual contracts. It should

22. The State Services Commission convenes a conference of departmental industrial relations personnel to express its views on the upcoming wage round, and this sets the background to the negotiations, which will still produce variations in detail among departments.

23. Employers and employees may administer their contracts themselves or may use an agent to act for them; the agent need not be the same one who represents them in negotiating contracts, bargaining (for collective contracts) or grievance procedures. Strikes and lockouts are legal after a collective employment contract is terminated, during negotiations for a new contract.

also be noted that in the public service, union membership was traditionally voluntary. Many public servants have taken advantage of the individual contracts allowed under the Act (for example, in the Treasury, all the people in the management ranks and some in the next rank down have done so).

Financial Management Reform - The *Public* Finance *Act* (1989)

The Pub/it *Finance Act (1989)* became the-other pillar of public **service reform, complementing the *State Sector Act*** (7988) and introducing a radically different system of financial management and accountability.

The reforms associated with the Pub/it *Finance Act (1989)* maybe described under the following headings:

a) Clarification of the notion of performance
b) Performance agreements
c) Appropriations
d) Departmental operations
e) Reporting
f) Parliamentary scrutiny

a) **Clarification of the notion of performance.** The traditional system of financial management and control in the New Zealand public service was focussed on the cash cost of inputs, such as: personnel (wages and benefits); travel, transport, and communications; maintenance; materials, supplies and services; other operating expenses; capital expenditure; and transfers and loans. Parliamentary appropriations were based on the need to fund these specific inputs. There was a complex system of centralized control, with detailed specification of delegations of authorities.

The essence of financial management reform was the replacement of the input-based system by one based on outcomes and outputs. **The basic concept is the distinction between outcomes and outputs.** Outcomes, as stated in the *Public Finance Act,* are "impacts on, or the consequences for, the community of the... activities of the Government". Ministers individually and the Cabinet collectively are responsible for defining the outcomes for which they will be held accountable to Parliament and, ultimately, the electorate. In order to achieve desired outcomes, ministers acquire appropriate outputs, which are defined as the goods and services produced by departments and other suppliers (specified in terms of quantity, quality, cost and time). Outputs are used to allocate resources and as a basis to measure performance. Producing an agreed level and quality of outputs, within agreed timeframes and costs, is the responsibility of the chief executive, and is reported on annually with the department's financial statements.

> The **framework** which reforms were **built** around was a ***clear*** *shift from* ***control*** *of* ***inputs*** *to the* ***accountability*** *for* ***outputs.*** *We moved from having* ***central*** *agencies with a very tight* ***control*** *over the* ***allocation*** *of inputs, to the management of* ***people*** *and* ***dollars*** *by* ***individual departments.*** *There was also a clear distinction between outputs and outcomes... [which] was a very* ***useful*** *process, because* ***it*** *did differentiate between those* ***things that a person could clearly*** *be accountable for [outputs] and those things which were environmental in nature, and which any number of* ***people could*** *influence, but which you* ***certainly could*** *not be accountable for [outcomes].*
>
> - Basil Logan (Convenor, Steering Group, 1991 Review of State Sector Reforms)

The output/outcome system has become the basis for the accountability relationship between ministers and chief executives. An important dimension of this relationship is the distinction made between the government as a whole — the Crown – and individual departments. Under the *Pub/it Finance Act (1989)*, the Crown is a distinct entity that regularly discloses its financial performance to Parliament and the electorate. The Crown's reporting complements departmental-level reporting. Thus, the chief executive of the Department of Social Welfare is accountable for the production of outputs, including the administration of social welfare benefits, but not for the nature and costs of the benefits themselves, as those are beyond his or her control and form part of the Crown's management of the public purse. Similarly, the revenues of the Department of Inland Revenue are not the tax revenues, but the payments from the Crown for providing specific outputs, such as services involved in the collection of revenue and the administration of income tax legislation.

Ministers "buy" outputs, including policy advice, from a number of sources, one of which may be their own department. **The minister's interests in the department take two forms: a "purchase" interest, in that the minister purchases the agreed outputs and the chief executive of a department supplies them; and an "ownership" interest, in that the minister wants to obtain the best possible return on the resources allocated to the department, at the same time seeking assurance that those resources are effectively safeguarded and enhanced.** A significant change from previous arrangements is therefore the accountability imposed on public servants for the use of resources.

The perspective of two different ministerial interests, as owner and as purchaser, has required better management of assets and improved financial information, including full specification of the costs of departmental services. This need for better financial information led to the adoption of Generally Accepted Accounting Practice (GAAP), so that accrual accounting replaced cash-based systems.

An important concept is that outputs are offered on a competitive, or "contestable", basis by departments. Contestability has two dimensions: an ability to compare outputs among departments; and an awareness of cost comparisons with producers of similar outputs in the private sector. Ministers may purchase the mix of goods and services from different departments, and from the private sector, that they judge best matches the outcomes they seek. However, some outputs, notably policy advice to the minister, tend to be provided from within a particular department.

Policy advice involves responsiveness to ministers in an environment of uncertainty, and is therefore more difficult to specify than other outputs. In particular, the performance measures used to assess the quality of policy advice differ from those used for other outputs. "Quality" standards, determined by the State Services Commission, are *purpose* – the aim is clear; *logic* – the assumptions are explicit, the argument logical and well supported by facts; *accuracy* — all relevant facts have been accurately included; *options* — an adequate range is presented, specifying benefits, costs and consequences; *consultation* — stakeholders are consulted and objections identified; *practicality* — it is technically feasible and addresses other matters related to implementation; and *presentation* – standards for concise and clear expression are met. "Coverage", a dimension of quality, is the capacity to react quickly, to evaluate policy impacts and to support the minister. Departments measure the quality of advice through a performance questionnaire submitted to ministers every six months, in which an assessment is given against the standards just cited. The specification of policy advice outputs is a recent development in the New Zealand model, first incorporated in purchase agreements in the 1993/94 fiscal year. (1. Ball 1993: p. 18)

The Road Safety Illustration

***Road** safety **as an** outcome is **politically desirable.** Politicians are prepared to invest resources in it. A **traditional** measure **of** road safety is **the** number of accidental deaths on the roads. But there are a number of outputs **that can** contribute to achieving the desired outcome, **including** more **police patrols,** improved road design and highway **signage,** the **regulation/control** of drinking and driving, better **hospital** treatment for accident victims and so on. The notion allows for consideration of the **contestability** of a **whole** range of otherwise **unrelated** activities in seeking to attain a particular outcome that politicians have decided is a **political** priority.*

\- Basil Logan

b) **Performance agreements.** The performance agreement between the chief executive and the responsible minister, the Estimates and the annual report are the key accountability documents both for chief executives and for departments. Performance agreements are in three parts:

- Part I specifies the key results areas related to the government's strategic concerns and requiring the personal attention of the chief executive. The expected results are expressed in verifiable terms, and include output-related tasks, management-related tasks and relationships with other departments and stakeholders.
- Part II sets out detailed information on the outputs to be purchased. Since 1993-94, this output information has taken the form of purchase agreements. Purchase agreements are intended to replace corporate plans in some departments (the latter have tended to be promotional documents). In recognition of a need for more explicit contracting and output specification, the purchase agreement is intended "to provide the Minister with information to assess the strategic importance and value of

departmental outputs and to make comparisons with similar outputs across both the public and private sectors." (The Treasury 1994: p. 10)

- Part III provides information on departmental compliance with statutory responsibilities and with government policies, and on the stewardship of public assets. It is intended to provide a means by which the government can better manage medium-and long-term commitments, and-decide on appropriate levels of investment (the ownership interest).

> The *essence of public management as it developed in the New Zealand context is an alignment between the actions and the results of the agents of government - chief* executives and their *departments - and the goals of government. These goals are now being framed in strategic terms;* agencies *at the centre of government, including the State services Commission, are* developing *a heightened capacity to link departmental outputs to government aims.*
>
> - Alex Matheson (senior official, State Services Commission)

The State Services Commission issues guidelines for performance agreements, with the exception of purchase agreements, for which the Treasury provides guidance. It should be noted that the performance agreement concept continues to evolve. The foregoing discussion is based on the 1993-94 State Services Commission Guidelines; the 1994-95 Guidelines call for the purchase (i.e. purchase agreement) parts of the performance agreement to be separated from the ownership parts, so that there would be greater focus on the personal role and contribution of the chief executive.

c) **Appropriations.** The previous line-item system (single departmental votes subdivided into programs and, within programs, into categories of inputs) was changed to an appropriation system based on outputs. Three types of appropriation were established: for acquisition of classes of outputs from the department; for injection of capital into the department; and for payments on behalf of the Crown. The latter involves acquisition of outputs from other public sector bodies and from the private sector, as well as transfer payments. Each department administers votes, which may include all three types of appropriations; votes represent the annual appropriations for which each minister is responsible. The Estimates contain annual appropriations for each government department and agency, including statements of projected performance and projected financial statements. After-the-fact performance information and financial statements are presented in departmental annual reports. (Starting with the 1995-96 fiscal year, the types of appropriation and the content of the Estimates will be modified — as later discussed.)

> *One of the early decisions that was made was that to get the incentives right for departmental managers and a/so for politicians, you needed to ensure that the budget system and the budget process reflected the nature of the performance system... for an output-focussed performance system, you needed an output-focussed budget system. Secondly, if the performance system was based on tots/costs, accrual costs, then the budget needed to be run on accrual terms as well. This was a key in fluence in the success of the reform because it encouraged consistency throughout the performance cycle — from the budgetary process through monitoring through after-the-fact reporting.*
>
> . Tony Dale (senior Treasury official)

As an example of the foregoing, the chief executive of the Department of Labour, in common with the chief executives of several other departments, is responsible to a number of ministers — in this case four: the Minister of Labour, the Minister responsible for Accident Rehabilitation, the Minister of Employment, and the Minister of Immigration – for the production of output classes set out in the statements of projected performance in the Estimates. The Department of Labour is funded to provide a wide range of employment-related services. In some cases, these services are actually provided by the private sector. For example, the Minister of Employment, through a vote administered by the Department of Labour, buys "Job Plus", a job placement service, from the private sector; in 1992-93, NZ $99.9 million was spent on Job Plus, while the class of outputs for placement services purchased from the Department used about half that amount, NZ $49.6 million.

The basis of appropriation was also changed to reflect the new accounting system: Mode B, put in place after a transitional cash-based Mode A, has seen all departments (and the Crown) produce full accrual-based financial statements, including a balance sheet.[24] **The implementation of accrual accounting brings with it the ability to account for the real costs of government resource use,** by providing managers with a more comprehensive picture of financial operations, and with better information for decision making and for reporting on results.[25] Amounts appropriated to departments are intended to cover the full costs of producing outputs, including depreciation. Chief executives thus receive funding to maintain the asset base needed to provide outputs.

Generally, departments cannot transfer funds between individual appropriations without parliamentary approval. However, the 1989 Pub/it *Finance* Act provides some limited flexibility. The Cabinet may, by Order in Council, authorize the transfer of amounts from one class of outputs (each class of outputs constitutes a single appropriation) to another, so long as the appropriation for any class of outputs is not increased by more than five percent, and the vote total is unaltered. Such a transfer can be made only once in any fiscal year.

Exhibits 5 and 6 provide an example of the output/outcome system in operation in the Ministry of Agriculture and Fisheries in 1992-93. (In 1994, this Ministry was divided into the Ministry of Agriculture and the Ministry of Fisheries.)

d) **Departmental operations. Financial management** and control have been devolved extensively from Treasury central control to departments (with the proviso that departments continue to provide Treasury with the information needed for its functions, including budget preparation and financial reporting). Chief executives are responsible for financial management, financial performance, accounting systems, and asset and cash management. The previously "rigid input controls exercised by the Treasury" (J. Boston 1987: p. 434) have been relaxed. Detailed and voluminous Treasury Instructions to departments used

24. There are two forms of Mode B, gross and net, depending on the type of output. Gross-basis appropriations are for outputs that departments sell only to the government, and rover all production costs; net-basis appropriations are for outputs produced by departments that collect outside revenue; like revolving funds, they allow resending of receipts without further appropriations. (F. Goldman, E. Brashares 1991: p. 83)

25. The governments of the United Kingdom and Australia have announced plans to progressively implement accrual accounting in departments and agencies. The Canadian government announced in its February 1995 Budget that it intended to adopt "full accrual amounting", involving principally the capitalization of physical assets and accounting of tax revenues on an accrual rather than cash basis. With some exceptions, individual Canadian departments and agencies have not prepared periodic reports or annual financial statements on an accrual basis,

to cover many operational procedures, and that type of control has lessened considerably. The Instructions now focus on financial management, accounting and investment policies. The Treasury also has issued concise guideline booklets in these areas.

> ***The thing** we achieved was to give **departments** autonomy to **let** them choose the quality of the management **information** system that was **put in place,** which in **turn** determined the **quality** of management Information **they** had to **support their** decision **making process.***
>
> **. Andrew Weeks (former senior Treasury official)**

e) **Reporting.** Outcome statements appear in the Estimates and departmental annual reports; outcomes are typically associated with individual ministers, who are accountable for them. Audited departmental financial statements and consolidated financial statements (of the Government of New Zealand — the Crown) are required annually under the *Public Finance Act* (1989). **Departmental financial statements must also contain a report on performance in non-financial terms,** through statements of objectives and service performance (which enable a comparison of the outputs produced with the objectives set at the beginning of the year). Departmental financial statements, contained in annual reports, include the following items:

- Statement of Financial Position*;
- Operating Statement*;
- Statement of Cash Flows";
- Statement of Objectives;
- Statement of Service Performance;
- Statement of Commitments*;
- Statement of Contingent Liabilities*;
- Statement of Unappropriated Expenditure";
- Statement of Accounting Policies*;
- Other Statements as necessary;
- Comparative Figure-s for Previous Years of all of the above; and
- Notes to the Financial Statements*.

The Financial Statements of the Government of New Zealand consist of the elements (asterisked above) from the statements of departments plus the following: Statement of Responsibility; Statement of Borrowings; Statement of Emergency Expenditure or Expenses; and Statement of Trust Money.

Exhibit 5
Outcomes and Outputs in the Ministry of Agriculture and Fisheries 1992-93

Like a number of New Zealand departments, the former Ministry of Agriculture and Fisheries reported to more than one minister in its case, the Minister of Agriculture and the Minister of Fisheries. In the Cabinet formed after the 1993 election, each of these ministers held two other portfolios. For example, the Minister of Fisheries was also responsible for LabOur (a separate department) and for Energy (a vote administered by the Department of Commerce).

Ministers purchase outputs from the Ministry; some outputs are also purchased from or sold to the private sector. The ministers' ownership interests involve good management of people, responsiveness to the Maori people, improved management of information and effective asset management The purchase and ownership interests are reflected in the annual performance agreement with the Director General (Chief Executive). An integral part of the performance agreement is the Corporate Contract and Purchase Agreement ("purchase agreement"), a document tabled in Parliament shortly after the start of the fiscal year (following the Estimates).

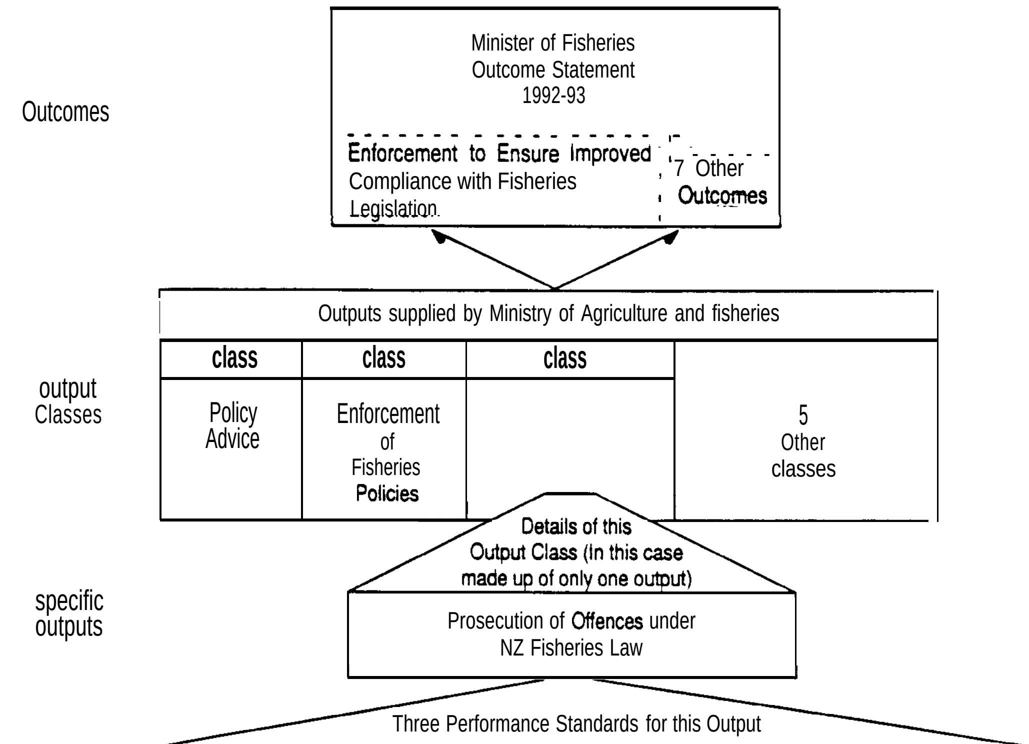
The first stage of the budget process is determining the outcomes the government seeks to attain, together with any changes in priorities. An example of an outcome sought by the Minister of Fisheries, one of 8 outcomes identified for the 1992-93 fiscal year, is "enforcement to ensure improved compliance with fisheries legislation". That outcome and other relevant outcomes are cited in relation to several classes of outputs, including policy advice, enforcement of fisheries policies, and prosecution of offences under New Zealand fisheries law. Each class of output maybe made up of one or more specific outputs. Consequently, more than one outcome is typically linked with each group of outputs. Linkages between outcomes and outputs are determined by ministers and their staff, in conjunction with Ministry staf the connection between particular outcomes and outputs maybe inferred, but is not disclosed as such. The purchase agreement, Estimates and Annual Report define the nature of the outputs and the performance standards for the quantity, quality, costs and timeliness of outputs purchased. The standards are published before–the–fact in the purchase agreement and in the Estimates, and the performance against these standards is disclosed after–the–fact in the Annual Report.

Exhibit 6 illustrates output specification and performance standards for one of the output classes purchased from the Ministry by the Minister of Fisheries. It shows the relationship between outcomes, output classes, specific outputs, output performance standards and the reporting of actual performance against these standards. (The Minister of Fisheries also purchases outputs from other government agencies and the private sector, but those outputs are not shown.)

Some classes of outputs, such as "Quality Management Services" (purchased by the Minister of Agriculture), are provided on a contestable basis, priced competitively with private sector suppliers. Quality Management Services encompass quality systems design, training, laboratory analysis, testing and monitoring end-point quality for clients involved in the primary production, processing and marketing of animal, plant, fish and dairy products. In 1991-92,86 percent of the revenues for this class of output were from the private sector, rising to 100 percent in 1992-93 (i.e., these activities are no longer dependent on appropriations).

The Report of the New Zealand Audit Office is included in departmental annual reports. In the case of the Ministry's Report for the year ended 30 June 1993, the Audit Office opinion was that the statements of account of the Ministry fairly reflected the achievements as measured against the performance standards and other measures, the financial results for the year, and the financial position at year-end.

Exhibit 6
Outcomes and Outputs - Minister of Fisheries



Output Performance Standards and Actual Performance

Performance Standards		Actual Performance	
Percentage of fisheries cases - prosecuted successfully - dismissed where a *prima facie case* was not established - dismissed through failure to meet statutory time limits	 80% 5% 0%	Percentage of fisheries cases: - prosecuted successfully - dismissed where a *prima* facie case was not established - dismissed through failure to meet statutory time limits	 96% 3% 0%
Percentage of seized or forfeited property with a value greater than NZ $5,000: - lost due to inadequate storage and security - reduced in value due to inadequate maintenance - disposed of as directed by the Minister - sold by public tender, auction or other commercial system realising prices consistent with current market value	 0% 0% 100% 100%0	Percentage of seized or forfeited property with a value greater than NZ S5,000: - lost due to inadequate storage and security - reduced in value due to inadequate maintenance - disposed of as directed by the Minister - sold by public tender, auction or other commercial system realising prices consistent with current market value	 0% 0% 100% 100%
Costs not to exceed revenue from the Crown and other sources.		Costs did not exceed revenue from the Crown and other sources.	

> The Audit Office also has taken on added responsibilities in relation to reporting requirements under the Pub/it *Finance Act (1989)*; it must prepare an audit opinion that includes the non-financial information, such as service performance, contained in departments' financial statements. These expanded audit responsibilities have significantly broadened the scope and evidential requirements of audit work.
>
> **Parliamentary scrutiny. The Act requires** the Estimates (first appropriation bill) to be introduced into the House of Representatives early in the fiscal year, to accommodate a three-part scrutiny process: review of the government's spending intentions in the Estimates, examination of departments' actual performance from annual reports, and examination of the performance of state-owned enterprises (this scrutiny has been extended to Crown entities and Crown Research Institutes – organizational forms defined under subsequent legislation). Each of those reviews may involve two to three months of select committee inquiry,[26] although in practice, Members of Parliament may not be devoting sufficient attention to committees, because they are reluctant to give uptime in the House for these "unglamorous and largely invisible" activities. (R. Laking 1994:p.313)

Attention to incentives is an important part of the financial reforms, Among these incentives are the capital charge, the charge applied against departments' capital base, and the related cash management scheme, involving interest payments to departments. These incentives are designed to improve the management of fixed assets and working capital, respectively

Under the cash management system, while the government's aggregate cash position is centrally managed, departments have their own bank accounts and are responsible for managing their own

26. Following parliamentary reforms in 1985, there are 14 subject-area select committees in the House of Representatives and another, on Officers of Parliament, that deals with parliamentary agencies. The committees review draft legislation; monitor and conduct special investigations into the policy, administration and expenditure of government agencies in their subject area; examine the Estimates; and consider petitions. They have the power to initiate their own inquiries, although much of their time is taken up with the scrutiny of proposed legislation. A key committee is Finance and Expenditure, which allocates the Estimates to other committees and examines broad questions of public expenditure. It reviews the Crown's annual financial statements, the Controller and Auditor-General's Report on the financial statements, and draft financial (including tax) legislation. The other 13 select committees are: Commerce Education and Science; Foreign Affairs and Defence; Government Administration; Internal Affairs and Local Government Justice and Law Reform; Labour; Maon Affairs; Planning and Development; Primary Production; Social Sciences; Transport; and a new committee, established in 1993, dealing with the performance of State trading bodies (SOEs).

working capital. They are subject to interest rate rewards and penalties based on how effectively they do so. The essence of the scheme is described as follows in a Treasury circular:

> Interest will be paid by the New Zealand Debt Management Office [NZDMO] at market-related rates on the net overnight balances of departmental bank accounts [NZDMO sweeps the accounts each evening and invests surplus cash in the overnight money market] . . . This return will be greatest where actual overnight balances equal the level forecast by departments. To the extent that actual and forecast balances diverge, the Crown's debt-servicing costs will rise. Accordingly, the return to departments will be reduced... (The Treasury 1990: p.4)

Thus, the system provides incentives to improve cash flow planning and forecasting and to keep departmental cash requirements in line with planned levels, as well as sanctions for failing to do so.

Under the second incentive, a capital charge is paid into the central accounts of the Treasury by departments. The same Treasury circular cited above indicates that the amount of the charge is derived by applying a capital charge rate to a department's capital base (i.e., the net amount of taxpayers' funds recorded in the department's audited financial statements). Recovery of the cost of capital is intended to reveal the full cost of producing outputs and to encourage departments to maximize their employment of capital. The capital charge rate is determined separately for each department, based where possible on relevant private sector rates; a senior Treasury official recently noted that the rate approximates 10 percent. (1. Ball 1994: p.22) The objectives and initial effects of the capital charge have been outlined elsewhere as follows:

> . . . firstly, to make clear the full cost of goods and services produced by departments and, secondly, to provide the information and incentives needed for efficient management of the Crown's investment in departments . . . [The Treasury reports] that the capital charge has already led to some capital rationalization. (J. Pallet 1992: p.5)

Another incentive intended to encourage improved asset management is the ability of departments to retain the proceeds of asset sales. Departments have also extended the practice of charging users, begun in the mid-1980s, which has been perceived as an incentive in the following terms:

> ...it discourages waste. Once a service is charged for, both government and private sector clients are forced to weigh up how much the service is really worth to them. if the current service is not worth the cost, the client has every incentive to request a lower quality product or less of it, and the public saves money. (R. Douglas 1986, cited in J. Boston 1987: p. 432-433)

Continuing and Consolidating the Reforms: The National Governments since 1990

As outlined above, from 1984 to 1990 the Labour governments carried out a series of public sector and public service reforms, and enacted the legislative framework for a new management model in the public service. Before the 1990 election, the National Party expressed some concern about certain aspects of the new management model, including the chief executive appointment process (seen as susceptible to "politicization") and the increasingly autonomous operation of departments (viewed as leading to "departmentalism" rather than pursuit of the public interest). After National's election victory, some of these concerns remained. In April 1991, Prime Minister Bolger referred disparagingly to the "little islands" culture in the public service, and called for "a high degree of integration, collaboration and co-operation between ministries and departments to achieve the best results."

The Review of State Sector Reforms (The Logan Review)

The National government quickly undertook to establish the worth of the reforms. The Cabinet State Sector Committee appointed a steering group in June 1991, charged with overseeing a comprehensive review of the reforms. Its terms of reference called for it to assess "the effectiveness of the State sector reforms, brought about by the *State Sector Act (1988)* and the *Public Finance Act (1989),* in improving the efficiency and effectiveness of the Public Service." The convenor of the steering group was Basil Logan, former chief executive of IBM New Zealand; the other members were mostly senior government officials.

The review set out to answer three questions posed by the Prime Minister:

- What were the reforms intended to achieve?
- What has happened so far as a result of the reform program? What benefits are being realized and what ongoing costs are being incurred?
- What more needs to be done to realize the objectives of the reforms and minimize their costs?

Based on interviews and discussions with ministers and senior officials, surveys of public service managers, consultations with the major public service union, and submissions received from a variety of interested parties, **the Review of State Sector Reforms reported in November 1991.**

The review's overall conclusion was very positive:

> In our view, the legislative framework for the Public Service reforms is sound. It has already had a significant and beneficial impact on the effectiveness and efficiency with which the core service operates...most people we spoke to or heard from [viewed] the framework of the reforms as sound [with] substantial benefits [being] realized. 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 areas as a result of the reforms. (p. 1,7)

The review's findings fell into two categories: those matters requiring "explicit attention", essential to the success of the reforms; and other problems, of a more transitional nature, that needed to be sorted out. The four essential areas — the "cornerstones" of any management system — were:

- the translation of collective strategies into organizational plans;
- accurate specification of required performance standards and measures into chief executives' agreements;
- objective measurement and reward for performance; and
- the creation of conditions for management of sufficient quality to be attracted, developed, retained and motivated to perform the reform's objectives.

Some largely transitional problems also posed a risk to the system as a whole. For example, the review found confusion about the roles and responsibilities of central agencies in facilitating reform in a number of areas, such as "lack of clarity of roles and process in output specification". The review went onto observe:

> It is not possible for the system to work unless central responsibilities and tasks are well specified, the structures and skills are in place, accountability mechanisms are working and the appropriate management philosophy is created. (p. 72)

Exhibit 7 presents a summary of the findings of the review.

No **major changes in direction emerged from the review; in fact the National government was seen to be strongly supportive of the reforms, and of the *Public Finance Act (1989)* in particular.** (J. Martin 1992: p. 14) Some key ministers acted to see the new management model carried through to completion. To illustrate, upon taking office in 1990, the government found that not all chief executives had performance agreements in place. The key ministers, as Graham

Exhibit 7
*The Review of **State Sector** Reforms **(1991)***

The review, based largely on interviews with ministers and surveys of senior officials and line managers, offered specific comments (and 40 recommendations) in the following areas:

- Parliamentary accountability. Although information to Parliament had improved, Members of Parliament needed more support in their scrutiny role. The broadening of the Audit Office's responsibilities as a result of the reforms meant a need to clarify the financial and non-financial information required by Parliament and the level of attestation in audit work.

  Although chief executives thought that improved performance information and reporting had achieved greater accountability, ministers were not so sure. Several ministers felt that the "collective interest" of Cabinet in its responsibility to Parliament and the electorate for planning and decision making was weekend more co-ordination from the Department of the Prime Minister and Cabinet was needed, for example, in budget formulation,

- Devolution. Devolution of resource management was identified as a principal benefit of reform, but ministers were concerned that they were exposed to greater risk from poor departmental decisions. The review recommended adoption of guiding principles for managing risk, based on tests of significance.

- Ministers and their chief executives. Although the framework of performance agreements and contracts was considered sound, there was concern that chief executives were not able to specify their performance adequately (part of the problem lay in the limitations of performance measurement) and that chief executives needed to be "more responsive" to the political environment.

- Central agencies. The review found overlaps and ambiguities in the roles of the State Services Commission and the Treasury, while the Prime Minister & Cabinet department needed to take a stronger role in strategy formulation.

- Senior management The appointment process for chief executives was sound, although more needed to be done to recruit candidates from the private sector. There was a need for a service-wide management development program.

- Human resource management. The reforms generally were considered to have improved recruitment, retention and management of people.

- Financial management. Problems have arisen in defining outputs: there are more rather than fewer appropriations, with inconsistent classes of outputs. Many departments have had difficulty understanding Mode B appropriations. Otherwise, there was general satisfaction with planning and budgeting processes and personal incentives (although further work was needed on incentives in the budget system).

- Monitoring and review. There has been confusion as a result of overlapping reviews. There are four levels of review currently: Audit Office value-for-money review the State Service Commission's reviews of chief executive performance; ad hoc Treasury and SSC review of areas ranging from property management to computers; and the Treasury quality assurance review of departments' financial systems.

Scott informed us, "pushed the other ministers to get this done [and] got the necessary directives through Cabinet."

> *Going into* the *[State Sector 1991] review,* it *was by no means clear-cut that the [National] government wanted [the reforms] to particularly continue as such.* But [the *Steering Group's] presentations to them indicated, basically, that despite some issues and concerns, it was still the best game in town; given all the alternatives, it was something which they should continue to support*
>
> - Basil Logan

The National government found the output-based budget system helpful, which reinforced its acceptance of the reforms. In 1991, its first year of operation, the system facilitated significant reductions in program spending. A senior Treasury official (Tony Dale) told us of the situation at the time of the 1991 Budget:

> It was a budget where the government was undera lot of fiscal pressure...and what happened that year was that they were able, for the first time in almost living memory, to make a significant real reduction in departmental expenditure...by deciding not to buy that [output] any more, or to buy this or that [output] . . .[They were able to go] through the budget output by output.

Furthering Reforms

Many of the Logan review's recommendations formed the basis for government actions to round out and complete the management model, The responsibility for reviewing and implementing recommendations was allocated to several departments, particularly the Treasury. [n some cases working groups were formed to develop specific measures. For example, a Treasury working group on output definition reported in mid-1 992; it called for the provision of better information to government from output suppliers (departments and others). The government agreed, and implemented these recommendations through purchase agreements, which form the second part of the performance agreement. By November 1992, the Treasury reported that "significant progress had been made with respect to output definition, output classes, budget process implementation, capital expenditure and chief executive performance agreements."

The review recommended improvements in performance agreements to ensure that chief executives were adequately responsive to ministers; in particular, performance agreements needed to reflect "a joint understanding of the main priorities for the minister/chief executive partnership for the coming year." The State Services Commission performance agreement guidelines have since been modified to better reflect key results areas that require the personal attention of the chief executive.

Senior management development is another key issue that arose out of the Logan review. In 1992, to address the difficulties associated with the Senior Executive Service, the State Services Commission established a steering group of chief executives on senior management development, under the chairmanship of the Commissioner. One early recommendation of this steering group led to the establishment in 1993-94 of a small Management Development Centre. Initially, the Centre will not itself provide training, but will act as a clearing house for information on development opportunities; its functions (as projected in the 1992-93 Report of the Commission) are to include

- development of a collegial approach to senior management development within the public service;
- collection and analysis of information about management development both within New Zealand and overseas:
- encouragement of business links between departments and management trainers and service providers;
- promotion of interaction with the private sector on management development issues;
- provision of career development information for senior managers; and
- continuing research and development about senior management development issues.

The principal conclusion of the management development steering group (reported in the same Annual Report) was that "any future managerial objectives were unlikely to be met by a single set of arrangements." Consequently, although it was likely that some form of service-wide executive group would be retained, the purposes of such a group, relating to succession planning, networking and development of management skills, were "all sufficiently distinct as to require different approaches."

In the 1993-94 fiscal year, the State Services Commission also initiated a project on ethics in the public service, which focusses on principles, conventions and practices. The rationale for this exercise arose from the belief that "signposts" to good practice needed to be erected and made visible; this need was apparent even before the reforms of the 1980s. An initial phase has involved the publication of guidance material for senior managers in the public service, following the promulgation by the Commission of the "Public Service Code of Conduct" (prescribed by the *State Sector Act* (1988)). Subsequent activities have included seminars and workshops on professionalism and public service ethics,

The National government has undertaken several other significant reforms, such as the labour market reforms noted earlier; one such fundamental measure, which affects the operation of government, is the ***Fiscal Responsibility Act (1994)*. This Act builds upon the reporting requirements in the *Public Finance Act (1989)*, and requires several new forms of disclosure of fiscal and economic information. The Act also establishes a set of five principles governing "responsible fiscal management".** Under these principles, the government is required to:

- reduce total Crown debt to prudent levels by achieving operating surpluses every year until a prudent debt level has been obtained;
- maintain total Crown debt at a prudent level by ensuring that on average operating expenses of the Crown do not exceed operating revenue;
- achieve and maintain levels of Crown net worth that provide a buffer against adverse future events;
- prudently manage the fiscal risks facing the Crown; and
- pursue policies consistent with a reasonable degree of predictability about the level and stability of tax rates for future years.

Any departure from these principles must be both transparent and temporary.

The Act is seen as an important incentive to encourage fiscally responsible government behaviour, and was first applied in relation to the 1994-95 Budget, tabled on 30 June 1994. The following key elements of the Act (in addition to the above principles) were identified in a Treasury overview

- Requirements for regular and explicit fiscal reporting and a more open and transparent budget process, including: a budget policy statement at least three months before the presentation of the budget, designed to signal the government's intentions to Parliament; medium-term (three-year) fiscal and economic outlooks in each budget; fiscal strategy reports (with projections of trends for 10 or more years); and a comprehensive fiscal and economic update prior to a general election.[27]

- A requirement for select committee review and parliamentary debate of fiscal reports.

> ***The [Fiscal Responsibility] Act provides for better information and analysis, a stable reporting cycle, a greater focus on strategy, less secrecy in budget planning, more scrutiny by Parliament and benchmarks to assess fiscal policy against... In the context of... fiscal reforms in recent years and on the assumption that a future government...is not determined to evade it, the Act can make a significant contribution [to fiscal policy].***
>
> - Graham Scott (1995: p. 9-10)

The *Public Finance Amendment Act (1994)*, which is related to the *Fiscal Responsibility Act,* makes changes to the appropriations, the Estimates and reporting requirements, including:

- Moving nondepartmental appropriations (previously on a cash basis) to an accrual basis, and increasing the number of types of appropriation, based on the purpose of the appropriations. In addition to the three types mentioned on page 40 above, in 1995-96 there will be appropriations for such items as Crown and departmental borrowing expenses, repayment of debt and sale of assets below market value.
- Revisions to the format of the Estimates, intended to make the documentation more complete (e.g., through presentation of financial information for the previous five years) and easier to use (e.g., starting in 1995-96, the format of the Estimates will present information about each appropriation separately from departmental information on expected outputs and performance).
- Publication of Crown and departmental financial statements if the House of Representatives is not sitting at the time the statements are due to be tabled.

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27. With coalition government more likely under mixed-member proportional representation, the budget policy statement (an overview document, indicating the government's priorities and long-term fiscal objectives) is intended to help maintain stable fiscal policy. The fiscal strategy report explains how budgetary measures relate to the broad objectives outlined in the budget policy statement; its projections analyze potentially serious future risks.

The Reforms In Perspective

The Progress and Results of the Reforms

As the record of public service reform — its activities, events and progress — emerges with greater clarity, so too does its impact — the difference it has made to government performance. Although no comprehensive evaluation of the reforms has been undertaken since the Logan review, an increasingly broad range of information on results can be brought to bear,

The fact that the reforms passed successfully through examination and review following the 1990 change in government (in the form of the Logan review) is, in itself, an important measure of their positive effects. The new government continued to press for full implementation of the management model, and pursued additional reforms.

In September 1993, the Hon. Bill Birch, then Minister of State Services, stated that "there has been a revolution in the public service", and went on to make several positive observations about the strengths of the management model:

> The scope and pace of change has been far-reaching and significant. Structures and systems have been radically reformed toward the ends of greater efficiency and productivity . . . . Much has been achieved by restructuring into business and service delivery units and by giving sharper focus in those ministries responsible for delivering policy advice . . . . The results have encouraged greater flexibility and accountability for the use of resources — including human resources. The focus has shifted from centralized controls to a concern for actual results... The *Public Finance Act* has extended and consolidated the management reforms of the *State Sector Act* by addressing the equally important issue of financial accountability. It also provides a more transparent basis for the allocation and monitoring of public expenditure.

From the initial stage of the passage of the Pub/it *Finance Act (1989),* the design of the management model has found favour with the Controller and Auditor-General. As part of a 1989 report on the Public Accounts, the Audit Office offered generally favorable comments on the anticipated changes in government management resulting from that Act. The accounting and financial management reforms are considered to have addressed "longstanding concerns", such as the "focus on the cash cost of inputs . . . [and] poorly defined notions of performance", identified in the Controller and Auditor–General's 1978 report (the Shailes Report) and earlier studies. (J. Pallet 1992: p. 8) In October 1993, an overall assessment of the quality of financial management rated most departments as adequate or better, including 15 that were "satisfactory", meeting basic requirements, and 15 that were "good", with a sound, well-managed system. However, worthwhile improvements were "possible or essential" in 25 departments, and the Controller and Auditor-General noted: "1 do not regard the process of financial management reform as complete." (Controller and Auditor-General 1994: p. 60)

As a result of the reforms, the public service is more efficient and also smaller, although the very large reduction in the number of public servants needs to be qualified by the impact of transfers from the public service to SOES and to Crown entities.

One reflection of efficiency is that, in three years, without adjustment to their budgets to reflect price increases, departments have shown little evidence of a decline in the volume or quality of output. There are also observable improvements in the use of assets generally, and in working capital and cash in particular. (G. Scott 1994: p. 13) Senior officials we interviewed indicated that improved cash management alone has generated sufficient savings to cover many of the costs of adjustment arising from the reforms.

There is also a view that "acknowledges the efficiency gains and the clarification of the managerial roles which have flowed from the reforms while reminding people of the costs [e.g., administrative disruption, loss of institutional memory and the impact of job losses]." (J. Martin 1992: p. 17)

In a 1994 report, entitled *NewZea/anti's Reformed State Sector*, the State Services Commission offered a positive view of the reforms, indicating:

> The now much smaller core Public Service is beginning to show clear improvement in operating efficiency and in responsiveness to clients. It rests the government less than it did ten years ago, and is no longer a regulatory impediment to ideas and productive energies in the wider economy and community. (p. 18)

Three key aspects of the reforms are seen as "extremely successful":

> Transparency in the activities and processes of the State, the liberation of managers from central input controls, and the new financial management and accounting systems are revolutionizing the ways in which departments and officials work. (p. 14)

The Commission's report sees the public service as "well beyond the half-way point" in being restructured to accommodate a reduced role for government departments, namely "to carry out core functions which for fundamental constitutional or political reasons cannot be corporatized, or purchased from Crown entities, or purchased from the private sector." Much remains to be done to complete the reforms, notably "in reviewing and refining the new systems [and] ensuring [that they] are as responsive as possible to the needs of both politicians and the public."

The Commission also assessed the "wider impact" of the reforms. In particular, it noted the negative effects of job losses: "The scale and significance of these impacts were underestimated."

Reflecting on the reforms to date, the Commission expressed the concern that its perspective is "partly subjective and partly based on the results to date"; and in consequence, **considering that sufficient time has elapsed since the onset of the reforms, the Commission called for a full, objective assessment of the results.**

The new management model is seen as having contributed to the government's improved fiscal situation in a number of ways. There is evidence of an enhanced ability on the part of ministers to control government expenditures, based on the arrangements in place on the departmental level: for the year ended 30 June 1992, cash flows declined by approximately NZ $1.5 billion on a base of NZ $31 billion. In addition, the greater transparency of financial reporting, through government-wide and departmental financial statements prepared on a full accrual basis, "acts . . . to ensure [that] decisions are made in recognition of their long-term impacts." (G. Scott 1994: p.14) As noted above, corporatization has also contributed to the improvement in the government's fiscal position.

A **milestone was reached in the 1993-94 fiscal year with the attainment of a budgetary surplus.**[28] Given the contribution of public service reforms to the government's improved fiscal balance, the question of their broader economic impact is raised. Although the New Zealand economy worsened significantly during the years immediately following the 1988-89 reforms, it began to turn around in 1992, and has continued to improve since then. A wide range of factors, including public policy decisions, have been responsible for this improvement. However, as the

28. The *Financial Statements of the Government of New Zealand for the year ended 30 June 1994* show a surplus of NZ S755 million, compared with a 1993 deficit of NZ S819 million. The New Zealand Institute of Economic Research forecasts continuing surpluses – to exceed NZ S6 billion (6 percent of Gross Domestic Product) in 1998-99.

State Services Commission noted in 1994, "It is generally accepted that New Zealand's economic restructuring and subsequent recovery could not have been accomplished if the State sector had retained its previous form." Several indicators of this economic recovery are in evidence:

> ***Managers have relished the opportunities presented by devolution and some at least of that flourishing of ideas and energies sought by the Government...has occurred. The Public Service has shed its stodgy, unadventurous, in some respects secretive character it had for many years.***
>
> - State Services Commission

- Growth in the economy has been stronger than expected (by 1993 there were signs of sustained economic growth – the first seen in 20 years), and inflation is low (less than 2 percent). This growth has been achieved as the world struggles to emerge from a period of prolonged recession. Although the recovery is linked to improved trade performance, structural reforms, including public service reform, are also considered to have played a role.
- One of the major international rating agencies upgraded New Zealand's foreign currency credit rating in March 1994.
- Employment has been growing steadily since March 1992.

In its 1993 Economic Survey of New Zealand, the OECD referred to "extensive structural reforms implemented since the mid-1 980s," including "enhanced efficiency in the public sector," and noted:

> Improved macroeconomic performance, following the long period of reform and adjustment, may provide a harbinger of stronger growth based on expanding the range and market share of New Zealand exports. The competitive gains that have occurred and seem likely to continue now provide New Zealand with the best opportunity it has had for many years to embark on a period of sustained non-inflationary growth. (p. 116)

The Swiss-based Economic Forum, in its 1993 Report on World Competitiveness, moved New Zealand from a ranking of fifteenth among OECD countries (out of 24) to eighth, and ranked it first in quality of government. This report also rated business community optimism in New Zealand second in the world, which is seen as "a very significant turnaround after most of the last twenty years in the doldrums." (State Services Commission 1994: p. 17)

In several respects, the public service reforms have sought to enhance the capacity of Parliament to hold the government to account for its decisions and performance. Greater transparency, cited above as one of the extremely successful elements of the reforms, financial statements based on the principles of accrual accounting, and audited statements of non-financial performance, are examples. An indication of the value of the reforms is that they have enjoyed bipartisan support from the major parties. In terms of results to date, parliamentary scrutiny of the performance of ministers and their officials is considered "relatively ineffectual", for a variety of reasons unrelated to public service reform, including the limited time that MPs devote to select committee activity and the inadequate resources provided to these committees. (J. Robertson, J. Chapman and M, Bradford, all cited in R. Laking 1994: p. 313) Nevertheless, some responsive changes have been noted in the way that Parliament and its committees review the Estimates and annual reports, and compare actual with planned performance. (G. Scott 1994: p. 12; R. Laking 1994: p.313)

Issues Relating to the Reforms

A variety of sources in New Zealand have discussed aspects of public service reforms, including academics, senior public servants, and some governmental organizations, such as the State Services Commission and the Controller and Auditor-General.

In what follows, we have selected a few themes of this discussion, based on the importance of the issues in question to the operation of the management model, and their relevance to our study. In so doing, we hope to provide a perspective on the reforms.

Concerns about Outcomes and Outputs

One issue is the distinction between outcomes and outputs. Some question whether outcomes can be defined in ways that enable the impact of outputs on them to be assessed.

There are a number of related issues:

- How to report on outcomes when no one can entirely be held accountable for them? The problem of measuring and attributing societal impacts is a difficult one, by no means unique to New Zealand. One advantage of the New Zealand management model is the ability to pose the question with greater precision than previously, so that outcomes can be better understood.

- Difficulties associated with measuring the quality of outputs, which raise the larger question of the capacity of performance measurement techniques to measure quality attributes.

- The risk that a focus on outputs will obscure the importance of outcomes; in other words, that high quality outputs may be produced – but not the ones leading to the desired outcome. From this point of view, public service managers may become more efficient but less effective. One answer to this concern lies with the ability of the model to generate abetter strategic focus for government decision making. Departments are seen to be thinking more explicitly about the extent to which their services (now that they know more precisely what those are) contribute to government goals.

- Ministers may focus on outcomes to the exclusion of outputs and thereby tend to avoid their responsibilities for all departmental activity.

> ***We are disengaging from decision making while at the same time establishing proper, genuinely effective systems of accountability and control. That way the Government is freed from the distractions of detailed daily management decisions, and can concentrate instead on broad policy directions and initiatives.***
>
> • Sir Roger Douglas (1988 Budget)

The distinction between outcomes and outputs is well established in the literature on the subject. Although New Zealand departments initially did tend to confuse outputs with outcomes, they seem to have worked their way through this problem. In the example of the Ministry of Agriculture and Fisheries, an outcome — food safety — may be linked to specific outputs, such as administration of quality assurance specifications, but the output can be specified with some precision, while the outcome may well be affected by matters not under the Ministry's control. Following study of the Logan review's findings, the Treasury has developed guidelines for purchase agreements to further assist departments with output specification.

In summary, four observations might be made about the outcome/output system:

- Governments are in fact accountable for outcomes, regardless of any reluctance a minister may have to be specific about any particular outcome.

- The system is designed to focus the government's attention on outcomes, and the arrangements for the purchase of outputs serve that end; ministers remain responsible for the full range of departmental activities.
- There is a need for a pragmatic approach to the specification of outcomes — for example, a focus on key outputs in relation to particularly desirable outcomes — as opposed to an attempt to establish comprehensive linkages among different types of outputs and outcomes.
- Relating outputs to outcomes is a dynamic process, and with each budget cycle institutional learning takes place, as answers are sought to the same basic questions.

Usefulness of the Organizational Separation of Policy and Operations

One dimension of the management model is the organizational separation of policy and operational matters. This structural reform was a response to the need to increase efficiency and to ensure strategic co-ordination of policy; making sure that institutional arrangements served the country's needs, by resolving conflicts of interest of policy makers and policy implementers — e.g., departments giving advice to ministers about the regulation of activities in which they were involved.

Opinion is divided on this issue. A number of concerns have been expressed about the prospect of separating policy and operations:[29]

- The reality that public servants make policy decisions in everyday program implementation is not recognized.
- Essential feedback between policy-implementers and policy-makers is disrupted.
- Policy and administration are best served by taking a pragmatic case-by-case approach — working it out along the way.
- In the current climate of rapid change, collaborative policy and administrative linkages help to ensure program effectiveness, while maintaining appropriate accountability relationships.

A related argument has been advanced to the effect that, in particular circumstances, a thoroughgoing separation, or "decoupling", of policy and operations may not be an optimal

29. These points have been raised in the Australian government's evaluation of public service reforms in that country. (see Commonwealth of Australia, Task Force on Management Improvement 1993: p. 505, 506)

arrangement. Among the circumstances in question: policy work that requires detailed operational knowledge and a high degree of co-operation between those responsible for policy and for implementation; outputs that are difficult to specify and monitor; and an organizational culture for policy advisors that differs strongly from that of implementers. It has been suggested that many of these factors were in evidence in the area of defence.

> ***Despite the formal decoupling of MOD from NZDF, the desired separation of defence policy from operational matters was not achieved in practice. There was no reduction in the influence of the military on defence policy-making. Greater contestability of advice was not forthcoming... In the case of defence...the argument for a strict [institutions/ separation of policy formulation from operations] is weak..***
>
> . B. Ewart and J. Boston (1993: p. 237, 238)

Defence decoupling was implemented in mid-1989 by restructuring the defence sector into two parts: the Ministry of Defence (MOD), a small policy-oriented department under civilian leadership; and the military forces (the New Zealand Defence Force- NZDF). In 1991, further organizational changes were made to improve policy co-ordination, and this, together with other analysis, has led to the suggestion that a too rigid separation of policy from operations is unworkable.

We were informed that the separation in the case of defence initially went too far. On the other hand, it was also suggested that care needs to be taken not to reject the very real benefits of the organizational changes. For example, it was pointed out that the military command now has greater control over resource management, which officials see as improving efficiency. In addition, the separation appears to work well for major capital projects, which are managed by the civilian MOD on behalf of the military. Individual base commanders also have greater freedom to manage; in the past, they had to have everything approved by MOD.

The beneficial effects of the separation of policy and operations are apparent to many. R.S. Deane, a former Chairman of the State Services Commission, has observed that "there is now a considerable body of evidence to suggest that . . . there should be separate sources of advice to ministers where conflicts of value may arise." (R.S. Deane in S. Walker,ed. 1989: p. 127) In addition, at least in some measure, the "clear improvements" in public service operating efficiency noted by the State Services Commission in 1994 maybe traced to the policy/operations split.

Practicality of the Purchase of Policy Advice

The comprehensive nature of the model has resulted in the formulation and development of policy advice outputs in basically the same way as operational outputs. Policy outputs therefore maybe purchased from one or more government departments, or from private sector suppliers, on a contestable or competitive basis. The prospect that the traditional relationship between ministers and public service policy advisors might be reformulated in this way has raised concern. If policy advice were contracted out, says one theoretical argument, the expertise and the trust residing in policy analysis groups might be lost. Moreover, policy advice is seen as intangible — not amenable to quantification – and therefore difficult to specify as an output.

> *Many of* ***the lessons*** *that have been* ***learned*** *in* ***respect*** *of other* ***services*** *a/so* ***apply*** *to* ***policy advice. . .*** ***. Getting clear*** *at the outset what* ***will*** *be produced* ***not only*** *gives* ***clarity, it*** *a/so provides a c/ear basis for* ***subsequent*** *accountability, . . .****Creating*** *an environment in which* ***departments*** *cannot presume that they have an automatic right to be the* ***sole*** *producer of* ***policy*** *advice in a particular area* ***creates*** *pressures and incentives to enhance the* ***value*** *of their services.*
>
> -1. Ball (1993: p. 28)

On the other side of this issue, some authoritative sources have pointed to progress in the specification of policy advice outputs. Following a 1993 study by the State Services Commission, a procedure using proxy or "shadow" market prices is to be implemented during the 1994-95 fiscal year. The aim is to create pressures and incentives for departments to strive to improve continually the quality of policy advice. One way suggested to do that is to leave open the possibility that other suppliers may win contracts to provide those outputs.

Concerns about the Role of Chief Executives

One of the reasons for the reforms in the appointment and employment arrangements for senior officials, based on contracts, was the desire for greater responsiveness to ministers. A tension has been perceived between this responsiveness and the important tradition, in Westminster systems, of chief executives, or their equivalents, ensuring the quality and continuity of advice to ministers. However, it should be noted that under State Service Commission guidelines for performance agreements, chief executives are contractually required "to provide the Minister with free and frank advice that is relevant, accurate and timely." Similarly, chief executives have been perceived as responding only to their minister's interests, rather than to the needs of the government as a whole. In fact, National governments since 1990 **have emphasized the collective interests of Cabinet,** and, in consequence, there has been greater use of interdepartmental committees and a chief executives forum has undertaken co–ordinating activities.

A related concern when the *State* Sector *Act (1988)* **was enacted was that there would be a loss of stability and** expertise-: through time-limited chief executive appointments. The evidence is that chief executives' terms have been renewed in many cases; others have moved to chief executive appointments in other departments. The general picture appears closer than expected to the situation before the *State Sector Act.*

> ***How are we to gain the advantages of stability and experience without entrenched conservatism and poor incentives for performance?*** Sure/y not by ***weakening accountability and insisting chief executives be old and permanent. / suggest we do it by continually strengthening the professions/, managerial and administrative ski//s of the pub/it service.***
>
> - Graham Scott

The Need to Improve Performance Reporting

Another area of concern has been compliance with legislated requirements for the reporting of non-financial performance information. In 1990, after reviewing approximately 100 of the statements of service performance newly required under the Pub/it *Finance Act (1989),* the Audit office issued a special report dealing with performance reporting in the public sector. In recognition of the need to develop standards in the area, this report offered guidance to government departments and agencies on the provision of highquality information that could be used to evaluate performance. The report laid out the Audit Office's expectations with respect to the evidence needed to support representations made in statements of service performance:

- There are identifiable information systems subject to controls that ensure that data are complete, accurate and authorized.
- Documentary evidence and work papers support what is reported in the statement.
- Organization staff are able to provide reasonable explanations in response to queries about the performance measures.

Departmental performance reporting has moved from a difficult initial period, when the Audit Office qualified many audit opinions on financial statements because of deficiencies in performance information, to the situation in 1993, when there were six such qualified opinions.[30] In 1994, the Audit Office reported on the quality of departmental statements of service performance and found that, although considerable progress had been made, areas for improvement still remained. The audit identified a range of problems that needed to be addressed, including the extent to which performance measures are linked to objectives and the need to improve reporting on actual performance against objectives. The Controller and Auditor-General noted: "Most... departments, although given clear opinions, can nevertheless improve how they measure and report their performance." (Controller and Auditor-General 1994: p. 54)

The Importance of People and Leadership Skills

An aspect of public sector management in New Zealand that increasingly has been recognized as important in attaining results, is the people factor. As the reform program unfolded, attention was initially focussed on structures, incentives and systems, but in later stages, institutional learning made it clear that only through people — their motivation, dedication, skills, training and experience — could excellence be achieved.

The notable success of the corporatization initiative was in part attributable to the quality of the people at the top — the commercial, financial and other skills of the directors, chief executives and senior staff, together with the leadership they provided to staff drawn primarily from the public service.

Sir Roger Douglas has identified, as one of his principles for successful reform: "for quality policies, you need quality people":

> Policy starts with people. It emerges from the quality of their observation, knowledge, analysis, imagination and ability to think laterally so as to develop the widest range of options. Replacing people who cannot or will not adapt to the new environment is pivotal. Getting the incentives and structure right can also transform the performance of many dynamic and capable people who were not able to achieve the right results under the old system. (R. Douglas 1993: p.219)

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30. An audit report is qualified if the auditor considers that information contained in the financial statements is incorrect or misleading to a degree that would influence the reader's understanding of the statements and the entity, Douglas has also commented that one reason why reforms in the commercial areas of the New Zealand government have been more successful than those in the core public service is that the people hired to run SOES were of higher quality than those typically attracted to fill top positions in the public service.

Further evidence of the importance of people lies in the observation, cited to us, that the significant variations in the rate of improvement in departmental performance to date, despite the fact that the structural and systemic changes were introduced to all of them at about the same time, is due to differences in the leadership skills of top officials.

The 1991 Logan review identified as a priority "the creation of conditions for management of sufficient quality to be attracted, developed, retained and motivated." An important response was the establishment of the Management Development Centre, and an increased effort by the community of departmental chief executives to address this identified need, A current concern, however, is the widening gap between chief executives' compensation packages and private sector market levels, and its consequences for the quality of job candidates.

Conclusion: Matters Of Particular Relevance To Canada

Public service management structures and practices in Canada are shaped by factors that are particular to the Canadian experience in some respects, and common across Western political systems in others. To some extent Canada must find its own solutions. But there is much that can be learned from other jurisdictions – from coming to understand their approaches and then adopting, or adapting, best practices.

As in Canada, reforms in the New Zealand public service have been undertaken in response to circumstances that were specific to it, on the one hand, and shared with other Western countries, on the other. By 1984, the incoming government was confronted by a level of state intervention that was considered excessive, even by New Zealand standards; external pressures on the economy were intense — a crisis was at hand; and, in some areas, public service management lagged behind developments elsewhere. Those factors were considered particular to the New Zealand context at the time.

However, in other respects that government was confronted by factors that were clearly not unique to New Zealand. These included:

(1) A deficit and debt situation that required concerted action: In addition to establishing measures to increase revenues, the government had to restrain, even reduce its spending. This obviously demanded strong political leadership — political will. But it also required the design of budgetary and related processes that would enhance the capacity of ministers to ensure that fiscal realities and other strategic priorities drove the framing of government expenditures.

(2) Policies that were patently counter productive: Public policies across a broad front had to be reshaped. Ministers agreed that this required rethinking both longstanding commitments to particular policy constituencies and the efficacy of traditional approaches to the role of government. It also required changes so that ministers would be better served byway of the information and advice they received in formulating policies.

(3) Management of government activities through highly centralized command and control systems with a plethora of constraints on those who deliver public services:

Increased productivity and, to a lesser extent, greater responsiveness to "clients" demanded changes to these systems. Key ministers and senior officials recognized that anew mindset regarding the critical importance of good management in the public sector had to be established. But this also required new structures and management processes to promote economy, efficiency and effectiveness.

(4) An approach to accountability that had become increasingly blurred and confused: Multiple and overlapping authorities and responsibilities had to be clarified. It was acknowledged that little change would be forthcoming until a serious effort was made to distinguish more precisely and visibly between the respective responsibilities and accountabilities of ministers and public servants. But it also required changes bearing on the relations of ministers and their officials, and improved methods of reporting to ministers and Parliament on the performance of government, its policies and operations.

In the period since 1984, successive New Zealand governments, led by two different political parties, have undertaken substantial, even radical, reforms of public policies, structures and management systems. After a transition period of deteriorating economic conditions, these public policy and public service reforms have had the positive effect of contributing to markedly improved economic and fiscal circumstances and prospects in New Zealand.

A great deal of attention to the New Zealand experience since 1984, on the part of Canadians and others, has focussed on the extent to which economic and social policies, and the role of government, have been transformed. Some aspects of this maybe quite relevant to Canada; others are not. Canadian governments need not emulate the New Zealand approach in each and every respect in order to gain from their experience, Moreover, some of this experience is more relevant to provincial governments than it is to the federal government, given the distribution of powers in our federal system.

Despite the many differences between the two countries, what clearly is relevant to the Canadian government are the various ways by which New Zealand has sought to address the shortcomings of public management listed above. In each of these respects, the present Canadian situation is substantially similar to the situation that confronted the incoming New Zealand government in 1984. What makes their experience especially important in these regards is that we now face fiscal imperatives that urgently demand fundamental reforms of public policies and management.

Gaining control of our burgeoning federal debt is now a key priority of the federal government. Fiscal manoeuvrability and program spending decisions are being seriously constrained by the size of the "interest bite" that must be paid on accumulated debt (now in excess of $500 billion and expected to exceed $540 billion by the end of the 1994-95 fiscal year). Furthermore, a Department of Finance report (A *New Framework for Economic Policy)* issued in October 1994 indicates that:

> ... at today's interest rates, if program spending remains at current levels (roughly equal to revenues), then in five years compound interest alone would cause accumulated debt to grow by almost fifty percent. (p. 72)

The expenditure reductions required cannot be accomplished simply by a continuation of past restraint measures. As was the case in New Zealand, the Canadian government has to reshape a wide range of policies and cutback programs to achieve affordable government. At the same time, it needs to reconsider a number of assumptions about the most effective ways to manage government and provide quality service. Furthermore, there is a need to promote anew frugality in decision making at all levels and to install systems and incentives that foster more productive management.

The New Zealand experience, in several important respects, demonstrates that fundamental change in what governments do, and how well they do it, must be accompanied by changes to the basic features of the public management system itself. In seeking lessons from this experience, we need to look at the different elements in New Zealand's approach to reform, while recognizing that these separate elements are components of a comprehensive and integrated management model.

Meeting Strategic Priorities: Strengthening the Budgetary Regime

The Canadian government's current fiscal dilemma is the result of two decades of persistent annual deficits at significantly higher levels (as a percentage of Gross Domestic Product) than any experienced in the 1960s or early 1970s. The 1993-94 federal deficit was a record high of $42 billion, and the 1994-95 deficit is projected to total almost S38 billion. During this period, many changes were recommended and made to the government's institutional structures and systems for planning, allocating and controlling public expenditures. The underlying aim of these reforms was, in the words of a former Secretary of the Treasury Board of Canada:

> . . . that public spending decisions should be disciplined by the nation's economic capacity and the government's fiscal limits. (A.W. Johnson 1992: p. 27)

Leaving aside the question of whether the political will has existed to achieve that aim, the budgetary regime in place has not been adequate in fostering fiscal discipline and expenditure restraint.

In the last decade, a variety of restraint measures have been imposed, but these were aimed primarily at the operating costs of government, including public service staff and their remuneration. By 1994, the government had instituted major policy and program reviews, with a view to reducing program expenditures, enhancing results by realigning programs with current and emerging needs, and, more broadly, seeking to "get government right" by clarifying the federal government's role in relation to those of other orders of government and other sectors of society.

In this context, it has become evident that reforms are urgently required to bring about the following:

(1) greater public awareness and understanding of both the current and long-term implications of the fiscal situation, and enhanced opportunities for public and parliamentary input to budgetary decisions;

(2) a greater focus on setting relatively precise and unambiguous objectives to be pursued by government organizations, in order to facilitate better budgetary decision making and enhance accountability for achieving results;

(3) improved systems and practices so that ministers and officials have the quality of financial and non-financial performance information, including information on the costs and effectiveness of programs, needed for a more strategic approach to public service management;

(4) a strengthened capacity of Parliament to examine and assess the linkages between the performance of government and the allocation of resources to achieve desired results; and

(5) an enhanced public reporting of the costs and results of government services and activities as measured against specified objectives and standards.

The New Zealand approach to these related requirements was predicated upon the assumption that it is necessary to distinguish between decisions concerning the desired outcomes of government action and decisions about the outputs of government that are undertaken in pursuit of these outcomes. This distinction was accepted as critical to the realization of the strategic priorities of ministers and to more productive management in government operations.

As a result, the government's financial and budgeting systems were redesigned, as outlined in the foregoing sections of this study. The objectives were: (i) to tighten ministerial control over total public spending; (ii) to clarify the outcomes that ministers seek to obtain from public spending (and the use of other policy instruments); (iii) to specify with greater precision what ministers expect to be accomplished when they purchase outputs from departments, as–reflected in various qualitative and quantitative performance criteria; (iv) to provide ministers and Parliament, on a regular basis, with more complete performance information, with analysis of any variance from prescribed results; and, finally, (v) to provide ministers, their officials and Parliament, with information on the costs of government that meets the standards of full accrual accounting methods.

It would be inaccurate to suggest that the New Zealand approach has not encountered some problems in implementation. Fine tuning of the basic processes and the addition of certain measures have been necessary. One such measure is the passage of legislation — the *Fiscal Responsibility Act* — that is intended to further enhance public reporting and to engender parliamentary debate on fiscal matters, for the purpose of encouraging fiscally responsible government behaviour. However, ministers and Parliament consider themselves to be better served by the fundamental redesign of their financial and budgetary systems. The key to this success has been the conscious effort to distinguish between outcomes and outputs. This is not a completely novel idea. But, as applied in New Zealand, it has had the positive effect of concentrating the focus of ministers on what they wish to accomplish, and on how they must allocate scarce resources accordingly. At the same time, the adoption of this distinction has had major consequences for more productive management in the design and delivery of public services.

Organizational Design: Separating Policy and Operations

Significant structural change has been a characteristic of Canada's federal government over the past two decades, as governments have sought to enhance ministerial control over the formulation and implementation of public policy and the management of government operations. Many of these changes were connected to the development of budgetary and financial management systems; others were effected in order to strengthen the co-ordinative capacities of the central apparatus of government to plan and implement horizontal policies and to ensure a corporate approach to the administrative dimensions of managing the public service,

However, the policy and management structures of the Canadian government became too complex and too constraining. In the case of policy structures, there were too many decision points in the governmental system. The size of the Cabinet and the number of departments and central agencies had both overloaded the central decision making system and diminished the capacities of individual ministers and departments to manage their policy and operational responsibilities. At the same time, the approach to management of administrative matters had led to an excessive degree of central control, as the system sought to maintain uniform standards across government and to ensure "error-free" administration.

The 1993 restructuring of the Cabinet, portfolio and departmental systems was meant to address several of these shortcomings. A smaller, two-tiered ministry structure replaced the large Cabinet, portfolios were consolidated, and departments were merged. On a separate track, some reduction of central corporate controls continued to be effected. In addition, an initiative begun in 1989 had established anew organizational form for the management of operations — special operating agencies (SOAs) within government departments. This new form of government organization built on both Canadian experience — for example, the use of Crown and departmental corporations, each with a measure of organizational separation from the conventional departmental form — and foreign experiences, including the British use of "executive agencies".

Special operating agencies were "designed to improve the delivery and cost effectiveness of government services" (Canada, *Pub/it Service 2000,1990:* p. 23-24) by granting them increased freedom from departmental and service-wide administrative rules in return for improved results. This new design was to be applied "to as many organizations as possible, particularly those that are involved in providing routine services to the public and to departments" (Canada, *Pub/it Service* 2000,1990: p. 24). By the end of 1993, however, only 15 such agencies had been established, comprising less than three percent of the full time equivalent staff of the public service.

Furthermore, a 1994 stocktaking study, commissioned jointly by our Office and the Treasury Board Secretariat, indicates that, so far, SOAs have proved disappointing in several respects. It found that "for certain government activities, SOAs should be able to provide better service at lower cost, and should therefore be continued" if specified conditions are met. For example, there is a need to set clearer and more concrete priorities as well as more rigorous performance goals. There is also a need to "establish more clearly the respective responsibilities of SOA heads and deputy ministers... and match these responsibilities with appropriate authority and discretion,..." Taken together, these specified conditions suggest that a fundamental and comprehensive rethinking of the design of SOAs is necessary, In our view, full consideration needs to be given to the potential for more efficient and responsive operational activities through the organizational separation of these activities from policy functions.

At the same time, the capacity of the public service to adequately serve ministers in the provision of policy advice has been a concern. Given our traditional approach to public service management, deputy ministers have multiple and demanding responsibilities pertaining to a wide range of policy, administrative and operational activities. The time they can devote to each of these is invariably limited; trade-offs are necessary, and finding sufficient time to reflect on important strategic issues is often difficult. Moreover, the high turnover of deputy ministers means that many have limited experience in their departments.

Over much of the last decade, ministers have often looked for policy advice to their political advisors and sources outside the public service, rather than to their deputy ministers and departmental staff. This may have led to a diminution in the policy capacity of departments at a time when issues are increasingly complex and interconnected and the government is faced with the urgent task of rethinking many of its policies.

The 1993 restructuring, among other changes, has the potential to better position ministers and the public service alike to meet the critical challenges confronting the government. In order to meet these challenges successfully, however, a greater organizational separation of policy and operational responsibilities may well be necessary. This appears even more important now as the new departmental structures are more, not less, complex organizations. An important objective of the restructuring was the enhancement of ministers' control and direction of their portfolios. If ministers are not to become bogged down by the scope of these portfolios, they must focus on the policies that they wish to pursue. Similarly, the need to provide ministers with quality policy advice requires that deputy ministers and other departmental officials with policy advisory responsibilities not become diverted from these crucial roles by the demands of re–engineering programs and managing the operational responsibilities now consolidated within these portfolios.

In New Zealand, clarity of objectives was recognized as a key principle behind management reforms; this, together with acceptance of the outcomes/outputs distinction logically led to an extensive separation of policy and operational responsibilities. Across almost the full spectrum of government, ministerial departments responsible for policy advice, including the monitoring and evaluation of policy implementation, have been separated from departments and other entities responsible for operations, that is, the delivery of public services, the enforcement of regulations, and soon.

The basic principles of ministerial responsibility have not been cast aside, however. Ministers are still responsible for the policies they adopt in pursuit of desired outcomes and for the outputs they decide to fund. Nonetheless, the responsibilities of chief executives of both types of departments, policy and operational, have been clarified in respect to their obligations to ministers. Ministers, in turn, benefit from increased access to competing sources of advice on the effectiveness of current activities, their options, and the levels of resources required.

The New Zealand experience in these areas, while not unique in all respects (executive agencies in Britain, for example, have been designed with some of the same features), demonstrates that it is possible, and can be beneficial, to seek the broadest possible separation of policy and operational responsibilities. There may be variations across different policy sectors in the extent to which the separation can (or should) be effected. However, it is clear that much more can be done to achieve this separation than has often been assumed, and that such a separation can both serve ministers in the pursuit of their policy agendas and contribute to greater productivity in the management of operations.

Delegation and Devolution of Authority

During the past decade, there have been several initiatives in the Canadian government designed to delegate increased authority from Treasury Board and its Secretariat, as well as from other central agencies and common services departments, to individual ministers, their deputies and line departments generally. The most recent government-wide reform effort, Public Service 2000 ("PS 2000"), built upon prior measures, including the Increased Ministerial Authority and Accountability initiative. PS 2000 reflected, as the 1990 White Paper on *Pub/it Service Renews/* put it, "the need for a fundamental overhaul of the way in which the Public Service is managed." According to the White Paper:

> ...the emphasis on system-wide conformity must be replaced with a combination of centrally-prescribed standards and much greater individual autonomy that can be applied flexibly across the range of administrative requirements. (p. 26)

The new approach was to include the delegation of authorities to "the lowest reasonable levels" in order to provide better quality and more responsive service to the public.

Over the past few years, central controls have been reduced, as ministers and their deputies have been given greater financial and administrative authority. Further, additional personnel management authority has been assigned to deputy ministers, primarily in connection with the Pub/it *Service Reform Act* passed in 1992. And, some delegation to lower level officials has taken place.

A "fundamental overhaul", nonetheless, has not been effected. In particular, the service-wide human resource management regime, with much of its legislative and administrative policy framework deriving from the 1960s, remains in place. Furthermore, the work of this Office and of others has shown that experience to date with authorities delegated to and within departments has not always produced positive results. This points to a number of underlying problems, such as the need to ensure that the abiding values of public service are imbued throughout government, that objectives are clear, that appropriate training accompanies the assignment of increased responsibilities and that the accountability of officials for the quality of their managerial decisions is enhanced.

Nonetheless, most government departments are large, diverse organizations that can be regarded as businesses in their own right. Within broad parameters, they should have considerable scope to establish administrative regimes well suited to their particular needs and should have the expert capacity to manage effectively in that regard. They should be directly accountable for the actions they take, or fail to take. Furthermore, in this era of rapid change, if the demands of Canadians for affordable, yet high-quality, efficient and responsive services are to be met, the delegation of authority within departments to officials closer to the front line cannot be avoided.

The New Zealand approach differs considerably from the Canadian experience to date in its commitment to the reduction of central controls and the delegation of authorities, and thus to a significant measure of devolution in the management of government operations, including the management of human resources. Given the restructuring to effect a separation of policy and operational departments, the principal central agencies, namely the Treasury and the State Services Commission, were required to divest themselves of many of the control functions they exercised at that time. In so doing, they accepted that devolution required a willingness to allow chief executives to exercise considerable authority to decide on the most economical and efficient ways to deploy their financial and human resources in pursuit of their responsibilities and obligations, especially, of course, as this applies to operational departments.

The Treasury retains legal controls over the disbursement, investment and other uses of public moneys. However, within a framework of legislated requirements and broad policies, departmental chief executives are now fully responsible for departmental financial management and performance, as well as for the management, information and accounting systems required to achieve the best possible results. Similarly, the State Services Commission has delegated its employer role to chief executives. Given the powers directly assigned in legislation to chief executives, they now are free to staff their organizations, to negotiate staff remuneration (within government-wide guidelines) and to design personnel management systems to suit the particular needs and circumstances of their departments. Finally, common services are no longer under central control; departments are essentially free to obtain required services from whatever sources they deem most appropriate and cost-effective. All of this means that the accountability of New Zealand's chief executives for the quality of management performance in their departments is much more explicit than in Canada, where the significant authority of central agencies over a range of management decisions diminishes the extent to which deputy ministers are viewed as responsible and accountable for management performance.

The significant devolution of authority in New Zealand, however, has been effected within a framework that involves the clear specification of desired results, effective monitoring of performance, and the application of incentives to achieve results in the most cost-effective manner. As well, devolution of management authority has been pursued within a framework of corporate management policies and with due regard to best practices. Chief executives, for instance, are required in law to meet the standards of being a "good employer", which includes responsibility for staffing on the basis of the merit principle and for adhering to employment equity policies; they are also responsible for ensuring that systems for managing their resources and operations are in place and meet high standards in respect to transparency, reliability and disclosure.

The experience in all these respects has not been without its trials and tribulations, but the evidence indicates not only that greater devolution is possible within the Westminster system, but that it can greatly facilitate more productive management.

Enhancing Ministerial and Public Service Accountability

Finding better ways to enhance accountability, both within government and to Parliament, has been an enduring concern in Canada, as it has been elsewhere. The Increased Ministerial Authority and Accountability initiative and the more recent Shared Management Agenda initiative of the Treasury Board Secretariat have each sought to enhance accountability by seeking to clarify responsibilities and performance expectations, and by providing, on a case-by-case basis, some management flexibilities. Strengthening accountability within and across government was a major theme of PS 2000 as well. Among other things, the federal government has committed itself, more than once in recent years, to improving its reporting to Parliament, to upgrading its use of program evaluation and its reporting of evaluations to Parliament, and to requiring departments and agencies to establish and publish service standards. The February 1995 Budget indicates that henceforth departments will prepare business plans and "outlook documents" that also will be subject to parliamentary and public scrutiny.

However, progress toward significantly improved accountability has been lamentably slow. This Office has reported on continuing shortcomings and deficiencies; parliamentarians remain critical of the extent to which ministerial and governmental accountability is secured; and successive governments, including the present one, have regularly acknowledged the need to make greater progress.

The importance of enhancing accountability cannot be overstated. It is the linchpin for securing effective, responsible government and good public management.

The New Zealand reforms have enhanced ministerial and public service accountability. This has been achieved primarily by linking the distinction between outcomes and outputs, the separation of policy and operational responsibilities, and the delegation and devolution of authority, to mechanisms for securing accountability.

The parliamentary appropriations process, for instance, provides increasingly detailed, and more intelligible, public information on the outcomes sought by ministers and the outputs they wish to fund in pursuit of these outcomes. Ministerial accountability has been strengthened by virtue of the extent to which Parliament and the public are better informed in these regards. In addition, the legislative framework governing accountability for results has reduced the discretion of the government in accounting to Parliament. The framework requires a much greater degree of disclosure of financial and non-financial information respecting actual performance. It also specifies in some detail the kind of information that government must provide. However, there is still considerable room for improvement imreporting on the extent to which the desired outcomes are being attained. While the parliamentary appropriations process remains a central focal point for partisan debate and political evaluation, the reforms in this area have improved the credibility and reliability of the information base upon which debate and evaluation occur. This serves to enhance ministerial accountability, but it also serves ministers and the government by more clearly defining the actual situation facing them.

Within government, the accountability of public servants has been strengthened by resorting to a more explicit contractual basis for relations between ministers and their chief executives. As described in previous sections of this paper, this encompasses both the performance expected of each chief executive and the policy and/or operational outputs purchased by the minister. Greater clarity in responsibilities, and thus accountabilities, has been the result. Further, the greater transparency of these relationships has further enhanced chief executive accountability to ministers. Equally important, the practical utility of this approach has been underscored by the significant delegation of authorities to chief executives made possible by enhanced accountability. Chief executives can be given the authority necessary to deliver the results expected of them because these results are clearly specified in advance. Given this structure of relations, chief executives have clear incentives to manage their departments in ways that serve ministers and the public – the delivery of their specified outputs (except in the case of confidential policy advice) is subject to regular and rigorous public reporting and audit requirements. In turn, this accountability regime gives chief executives every incentive to develop well-performing organizations, encompassing devolved authority and accountability, precisely because the performance of the chief executive is intimately tied to the performance of her or his subordinates and the effectiveness of departmental management systems and operational procedures.

Making Change Happen

A number of public service management reforms over the last several decades have served to improve governance in Canada. In too many cases, however, reform measures have failed to realize their full potential. In part, this has been due to a disjointed or ad hoc approach, or to other implementation failings, as illustrated in our 1993 study of public service reform (Chapter 6 of the 1993 Annual Report). That study found little disagreement with the fundamental values that PS 2000 sought to promote or with the broad thrusts of that initiative. Certainly the need for fundamental change was widely accepted. Furthermore, in some departments and agencies, or parts thereof, progress had been made, although sometimes as a result of initiatives only loosely, if at all, connected to PS 2000. However, overall, the desired results had not been obtained, largely because the necessary commitment from key players did not exist or because the reforms were not adequately integrated with fiscal realities and with broader government objectives. Given these problems, it is not surprising that mixed messages had been communicated, expectations had been badly managed, and the behaviour of ministers and senior officials too often had contradicted reform rhetoric. Coherence and consistency are usually the first victims of disjointed approaches to reform. Skepticism and cynicism among the ranks inevitably follow.

Until 1984, experience in New Zealand seems to have echoed our own. Problems in public service management had long been known to exist. Many initiatives had been undertaken with only limited success. The inertia of the bureaucracy and lack of political will had been too much to overcome. However, led by a small group of ministers in key portfolios who saw the need for fundamental change, with strong support from certain officials, the reforms begun in the mid-1980s finally addressed these problems effectively. The success of these public service reforms is attributable in part to the fact that they were an integral part of the broader economic and social policy reform program on which the government had embarked. The strong political commitment that was present from the start has continued to be much in evidence throughout the last decade, even with intervening changes in government. But other factors were equally important, notably the coherence of the reform program and the leadership of key central agency officials who oversaw its development and articulation, and who drove its implementation. As well, the use of legislative levers, and the incorporation into the management model of incentives to enhance productive performance, were instrumental in overcoming the inertia that had plagued earlier reform initiatives.

The wider international experience also illustrates that a significant reform program, to be successful, must jell as an integral whole; the pieces must come together. Some governments have succeeded in putting the pieces together reasonably well; others have not. The international experience also makes clear that coherence and consistency in a major reform program are unlikely to be forthcoming without a strong and sustained commitment from political leaders. Perfunctory political commitment will not suffice. At the same time, political will, in itself, is not sufficient. As the New Zealand case demonstrates, it is also necessary for ministers and officials to agree on a reform strategy that links improved governance to improved management. This requires that reforms not only serve, and be seen to serve, the broad policy agenda of ministers, but that they address management shortcomings progressively, on the basis of a well thought-out, coherent and practical course of action.

Over the last year the Canadian government has been grappling with crucial budgetary, policy and program decisions. Its February 1995 Budget reflects significant cutbacks to programs and other changes that will have a major impact on the structure and size of the public service. In that context, a concerted effort will be required on the government's part to re-establish an environment of stability and to regain the momentum for "renewal" within the public service so essential to maintaining the vitality of the institution.

At the same time, while acknowledging the urgency with which the Canadian federal government must tackle its fiscal dilemma, a deliberate, continuous and sustained effort at much-needed and fundamental change must be pursued. With the recent restructuring, and a start in redefining the roles of the federal government, the opportunity exists to make progress in delineating the appropriate roles of ministers and public servants, addressing the organizational separation of policy and operational responsibilities, delegating and devolving authority, and enhancing ministerial and public service accountability. There are no quick fixes to the shortcomings in Canadian public management; from that perspective, even with upcoming changes, we will have just begun to "get government right".

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