# POLITICAL ACCOUNTABILITY AND PUBLIC SECTOR PERFORMANCE MANAGEMENT: EXPLORING THE LINKAGES AND LESSONS

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**"Government may need managing, but management could use a little governing too"**
Henry Mintzberg
Harvard Business Review May/June 1996

The world hit the new millennium in a state of profound transformation and structural change. The twin forces of globalisation and technology have driven much of that transformation and change. These forces are at work world wide, and there is no hiding place. Our personal lives, our economic horizons and opportunities, the way in which we function as a society and the way in which we are governed are all being radically reshaped by these forces.

The challenges for representative democracies and political leadership are huge. In a world of the free flow of ideas, people, trade and capital the sanctions for poor governance or poor quality policy are swift and they are savage.

This paper offers a perspective drawn from my twin experiences;

- the experience of practical politics; I was New Zealand's Minister of Finance from 1990 – 1993, and a member of the New Zealand Parliament for 14 years.
- The practice of radical reform; both as an architect of radical reform in New Zealand in the early 90's, and a reform "coach" in many countries subsequently.

**First things first**

The starting point is not accountability for performance at the narrow level of the public sector. A better place to begin is by thinking of performance in its broadest sense as the measure of our ambition as a nation. A big picture view of performance involves identifying our economic and social development goals, articulating our vision for individual education and opportunity, and determining the kind of physical and political environment we would want to enjoy.

The achievement of these multiple ambitions will depend not just on what a government does. Increasingly it will depend on the ability of individuals, their capacity to harness technology, and their success in the global markets in which they operate.

By definition, governments and those who aspire to govern will need to behave and operate in a way that best advances the achievement of these performance measures.

**The traditional State; mugged by reality**

World wide, irrespective of the state of development of a country, and irrespective of the philosophical bent of the incumbent government, transformation of the role of the state is the common denominator. While New Zealand has been something of a pioneer, to varying degrees all governments are addressing fundamental questions about their core tasks; what a government can and cannot do, and how the public sector should be managed. In short, most nations grapple with the questions of what the state should do, and how best it should do it.

When every political incentive is to maintain the status quo and not to rock the boat, why is it that many and varied governments have embarked on the path of radical reform? The answer is that the status quo of the big state and unaccountable bureaucracies hasn't worked and is no longer affordable. Many nations suffer not just a fiscal deficit but governance, institutional and performance deficits as well.

This paper is designed to:

- Re-examine the basis for and effectiveness of government interventions
- Diagnose the causes of failure in the traditional bureaucratic model
- Identify the conceptual basis and key characteristics of a performance management regime
- Describe and assess the new management tools that help ensure accountability for performance
- Focus on the big shifts that occur at both the political and official level when the system moves from rule-based to strategic control
- Isolate the pressure and "choke" points for politicians in the performance management regimes
- Draw some lessons from the New Zealand experience that will serve to enhance and sustain the reforms

## GOVERNMENT INTERVENTIONS:
## What the state should do - and not do

Government is by definition an exercise in intervention. Typically these interventions take three forms:

1. ***Ownership*** – the state will own a range of business entities and service delivery agencies. In essence the state is a producer of goods and services.

2. ***Purchase*** – the state is a big purchaser of goods and services on behalf of citizens. The budgets of many nations typically allocate up to 80% for the purchase of education, health and social services. These purchases are funded by taxes, borrowings and to a minimal extent by user charges.

3. ***Regulatory*** – the state is not just a player [owner] and purchaser, but also a referee. The state sets the rules of the game across a broad range of public and private activities.

Traditionally it has been assumed that active interventions by the state in all three spheres are the best way to advance the public interest, to produce an array of public goods and to promote optimum social and economic outcomes.

The reality has been quite different.

The Government as ***owner*** has squandered resources, diminished the value of the business and delivered, too often, lousy services to citizens.

The Government as ***purchaser*** has overspent, failed to get value for money, produced moral hazard, denied citizens choices and accountability for services and crowded out more efficient and effective private delivery of goods and services.

The Government as ***regulator*** has distorted markets, shielded poor performers, misallocated resources, added to the transactional costs and compromised competitiveness.

The rationale for intervention demands a fundamental rethink, as does the concept of public goods. When the state seeks to justify any one of the interventions, it will typically argue the public goods rationale. On closer scrutiny it is often revealed that not all of the goods being provided are in fact public goods. There are two main types of goods – public goods and private goods. Each good belongs somewhere on a continuum from "pure public" to "pure private". The conceptual distinction is well known and important to make. *[1*]

Pure *public* goods have two defining characteristics; they are non-excludable and consumption of them is non-rivalous. The consumption of *private* goods is the reverse. In the middle of this continuum are *merit* goods. The Government may decide to provide access to a good as if it were wholly or partly a public good, even if the good concerned has the natural properties [rivalry & excludability] of a private good. Education is a most obvious example of a merit good. Public & merit goods can be provided by any one of the three typical state interventions:

- By production
- By purchase
- By regulation

Going back to first principles, two critical questions need to be asked of any government activity at the outset:

- Is what is being provided or regulated a genuine public good or merit goods?; or is it really private goods in which case the Government has no reason to be involved.
- Is the outcome or results that the Government seeks [eg better economic or social development] actually best advanced by the ownership, purchase or regulatory intervention the state proposes to make? For example the state has traditionally been the owner of a monopoly telecommunications business. What is now evident is that globalisation and technology imperatives demand world class telecommunication services. These are best supplied not by a bureaucratically operated, intellectual and financial capital starved state owned business. The state can best advance the desired outcome by getting out of the business of telecommunications ownership and production and using its regulatory intervention to ensure the competitive private supply of telecommunication services.

So the starting point for any drive for a public sector performance management regime is to ask the fundamental question – what should the state do, and not do. The solution to a whole bunch of state performance problems is to first exit the state from a whole range of counter productive interventions it currently makes. There is no merit in trying to fix "how" the state should operate before addressing "what" should the state do.

## BEYOND BUREAUCRACIES:
## How the state should not operate

The fatal flaw of bureaucratic regimes are well documented. My favourite two recitals of the litany of bureaucratic woes come from two influential New Zealand reformers – Dr Roderick Deane, Chairman of the State Services Commission responsible for overseeing the radical transformation of the public sector, and Dr Graham Scott, Secretary of the Treasury who had a similar role in respect of the radical restructuring of the New Zealand economy.

> "Confusion of objectives, lack of accountability, inadequate adaptability to change, over-centralised control mechanisms, multi-layered management structures, excessive paperwork burdens, dispersion of responsibility, widespread internal protective mechanisms and, ultimately, an inability to exert appropriate control over government expenditure … characterise large parts of the public sector."
>
> *Dr Roderick Deane [2]*

- "Objectives for departments were not clearly specified
- The respective responsibilities of politicians and civil servants were confused, so that lines of accountability and responsibility were never clear
- The control systems administered by central agencies curtailed freedom to manage effectively, generally destroying incentives to perform
- There were few sanctions for poor performance
- Ministers were making inappropriate decisions about the internal management of departments."

*Dr Graham Scott [3]*

Quite apart from the fundamental failure of bureaucracies in management terms, the traditional public sector suffers from two other handicaps. The first is that many public servants are recruited on the basis of their political allegiances, not their professional qualities. The second is that permanent tenure regimes deny the ability to institute the strategic management of human resources in the public sector.

### Politics before professionalism

While some will make the case for "the face has to fit" to justify the injection of political recruits into the ranks of the public sector, sadly the most common rationale is crude payoff for political favours or nepotism.  Political, as opposed to professional, screening for staffing the public sector is corrosive of quality and performance, and therefore accountability.

**Permanent tenure – destructive of the strategic management of human resources**

The job for life mentality that is a feature of so many public sector laws and attitudes is at odds with modern approaches to human resource management. In a world that is fast and flexibility is at a premium, the public sector should not expect to be exempt from these forces. As governments rethink their role, downsize and modernise the state, so the skills and requirements for their public servants shift. An employment straight-jacket makes no sense; the Government must be able to set its strategic objectives and have recruited professional public servants who have the capacity and skill to advance those objectives.

## PUBLIC SECTOR PERFORMANCE MANAGEMENT REGIME: Key ideas and characteristics

The public sector reforms carried out in New Zealand commencing in the late 1980's were heralded at their inception to be bold and unprecedented.

The objectives of reform have centred around effectiveness, efficiency, accountability, transparency and consistency. Key elements of the reform process have included:

- The corporatisation and privatisation of government trading enterprises
- Departmental restructuring to rationalise the functions and shape of the core Public Service, particularly by separating policy advice, service delivery and regulatory functions, and related to this the separation of the roles of funder, provider and purchaser. Some of the service delivery functions have moved to a group of non-departmental agencies know as Crown entities
- Decentralisation of departmental management with chief executives responsible for decision making with respect to human resources and the selection and purchase of inputs
- An increased use of contracts [eg performance agreements between Ministers and departmental chief executives, purchase agreements between Ministers and departments, contracts between funders and purchasers and between purchasers and providers]
- A change in the basis of state sector financial management through the introduction of accrual accounting, from a focus on inputs to a focus on outputs and outcomes

A defining feature of the New Zealand reforms is the fact that they were shaped by certain bodies of economic and administrative theory; notably: public choice theory, agency theory, transaction cost economics, managerialism and new public management. *[4]*

Fundamental to the core state sector reforms has been a switch in focus from inputs-based thinking to an outputs-based approach. There is also an important distinction between "outputs" and "outcomes".

*Outcomes*
The social and economic results sought by the Government, and are determined by Ministers. A focus on outcomes allows Ministers to concentrate their efforts at the strategic level, and to set priorities for the allocation of public resources.

*Outputs*
The goods and services produced by the core public agencies. Departmental outputs assist the Government to achieve its wider desired outcomes. The outputs of a department are determined by the Minister and are specified in an annual departmental purchase agreement, which is agreed between the Minister and the Department's Chief Executive. All budgetary allocations occur on an output basis. This enables the Minister to see clearly what he or she is "buying" from his or her Department, and at what price.

*Inputs*
The resources used to produce the outputs. Previously departments had been subject to a wide range of controls over their use of inputs. This system was overcentralised, arbitrary and inefficient. With the shift to output-based thinking, departments now enjoy substantial freedom in the acquisition and mix of inputs, including staff and capital.

The World Bank in its benchmark "The State in a Changing World" Report puts the New Zealand reforms in a global context:

> "There is a growing trend to set up focussed, performance-based public agencies with more clarity of purpose and greater managerial accountability for outputs or outcomes. New Zealand provides the most dramatic example among the high income countries. It broke up its conglomerate ministries into focussed business units, headed by chief executives on fixed-term, output based contracts with the authority to hire and fire and to bargain collectively." *[5]*

In a New Zealand commissioned review of the reforms by Professor Allen Shick, he concludes on the following note:

> "The reformed state sector is testament to the power of ideas and the inventiveness of its architects. It is a singular accomplishment in the development of modern public administration, and it will influence the future course of management both in New Zealand and other countries. It is worth briefly reviewing the roll call of some of its pioneering accomplishments. New Zealand has been the first country to fully adopt cost based accounting and budgeting; the first to successfully implement techniques of output budgeting; the first to give managers full discretion in using inputs; the first to introduce strong incentives for the efficient use of capital; the first to require advance specification of the outputs to be purchased; the first to establish a comprehensive accountability regime." *[6]*

The public management reforms implemented in the 1980s were founded on five related principles. These were:

- *clarity of objectives* - clear specification of the objectives managers are required to achieve is a necessary condition. These should be stated as measurable indicators of individual performance. Clear specification also means that objectives should not conflict;

- *freedom to manage* - managers, at all levels, should be given the power to achieve the objectives specified. Managers will then be able to make resource allocation to enable the most efficient achievement of objectives;

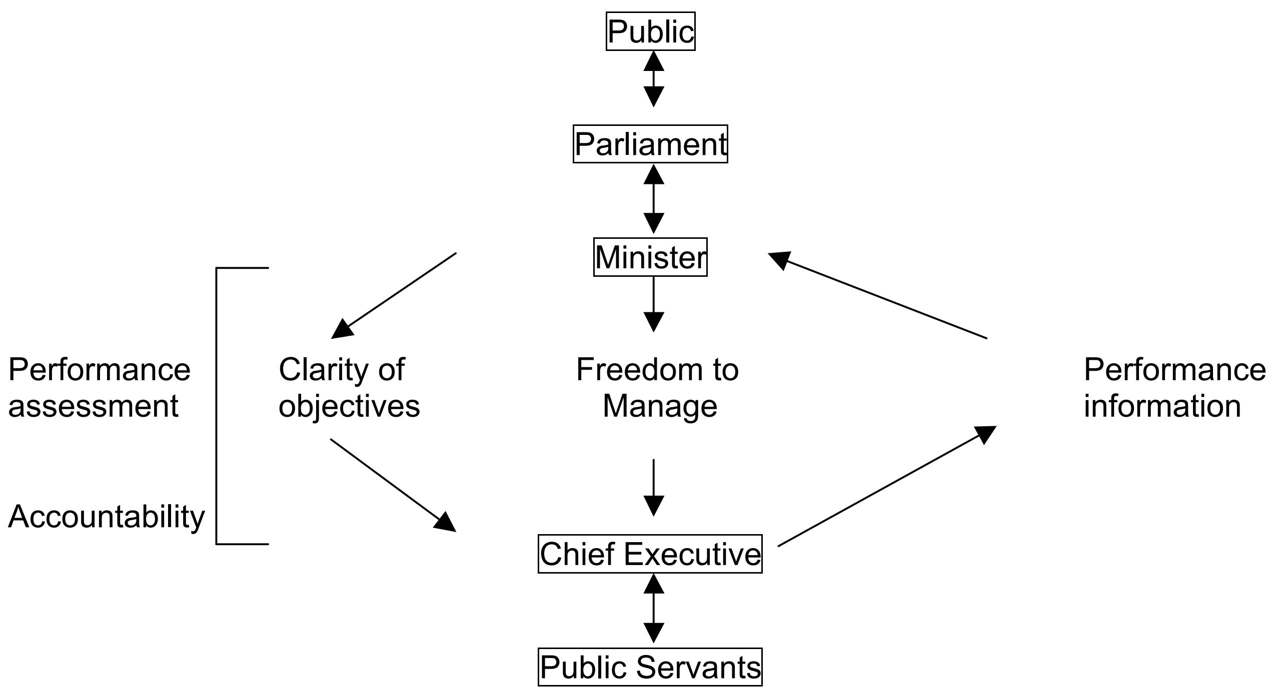
- *accountability* - in return for the freedom to manage, managers must be accountable for the decisions they make. This will provide the necessary sanctions and incentives to modify behaviour and ensure that managers meet their objectives;

- *adequate information flows* - the accountability systems must provide information that enables the assessment of the quality of managers' resource decisions; and

- *effective assessment of performance* - managers must be assessed on how well they met their objectives and any deficiencies due to poor management revealed and sanctioned. *[7]*

The following logic was employed to show how those five conditions were to result in increased public service efficiency and effectiveness. If managers are clear about what is expected of them (clarity of objectives) and are given the power to achieve their specified objectives (freedom to manage) and then made accountable for achieving the objectives by being judged (accountability), with quality information (adequate information flows) on how well they met their stated objectives (effective assessment of performance), managers will make efficient resource allocation decisions and obtain objectives in the most efficient way. A depiction of the relationships this logic prescribes is provided below:

**Key Accountability Relationships in the NZ Public Service**



In short, the public management system envisaged by the architects of the reforms sought to clarify responsibility in the system, in particular, to increase the responsibility of department heads for managing their departments and to increase their accountability for the exercise of that responsibility. Chief executives would be contracted to produce the specified outputs and have control over 'the resources required to produce those outputs. Ministers, for their part, would be responsible for clarifying the outcomes their government sought and for purchasing outputs to achieve those outcomes. *[8]*

The feature that most characterises the New Zealand performance management model is the design coherence. The reforms are internally consistent parts of a single integrated management system. It is a feature of the reforms that this notion of “performance” has permeated the whole system, including the nature of chief executive performance agreements, the departmental and state agency budgets, the nature of appropriations made by Parliament to the Executive, and the form of departmental and whole-of-government financial and non-financial reporting.

## PUBLIC SECTOR PERFORMANCE MANAGEMENT: New tools to do the job

The key elements of the redesigned public sector management system are:

- Clear definitions of performance and unambiguous managerial accountability
- Delegated authority commensurate with responsibilities
- Strong performance incentives
- Requirement for high quality reporting

### Performance definition and managerial accountability

The performance expected of departmental managers is defined in terms of two dimensions:

- The outputs [goods or services] the department is to produce, and
- The financial performance of the department

The output orientation focuses managers on what they are producing and not merely the resources they are managing.

The cost is measured on an accruals basis and is determined by allocating all a department’s input costs [staff costs, operating costs etc.] to the output classes using standard management accounting techniques.

Outputs are defined, regardless of who they are provided to. In the case of a typical department, their outputs are “sold” to their Minister who buys them on behalf of the government and the taxpayer. In this way the Minister is viewed as a customer of the department. The important distinction here is that the Minister is purchasing the outputs even though he or she does not personally receive the service. In this sense there is a distinction drawn between the purchaser and the recipient of the service.

Internally the Department defines the outputs or output component that each manager is responsible for delivering. These definitions are then used as the basis for the annual performance agreement between the Minister and the Chief Executive and between the Chief Executive and his or her managers'. Those managers then enter into similar output based performance agreements with their staff and so on. In this way the output orientation is internalised into the performance management system of the department.

Another advantage of an outputs focus is that it allows the cost of internally produced outputs to be compared with similar externally produced outputs. This provides opportunities to improve performance through contestability.

Financial performance is usually defined in fairly conventional commercial terms. In the case of a typical department it consists of targets for:

- Revenue, expenses and net surplus
- Cash flows
- Working capital
- Physical asset utilisation

As with output performance, it is usual for chief executives to break down the department's overall financial performance targets into targets for each of the senior managers. These are also included in annual performance agreements, ensuring that financial performance is an integral part of the department's management system.

By clearly defining performance in this way, managerial accountability can also be clearly established: delivering outputs of a specified quantity, quality and cost and ensuring financial targets are met.

**Delegated Authority**

A second element of the management system is the delegation of authority over inputs (personnel, equipment, etc.). This allows managers to select the optimal mix of inputs to produce their outputs - the decision that is at the heart of the production function.

This delegation does not necessarily mean any reduction in financial control. Providing all input costs are allocated to outputs (and there is a requirement that this occur) then all input decisions are reflected in the cost of outputs. Increases in input costs or poor utilisation of inputs will be reflected in increased output costs.

In this way Ministers know that while departmental managers might be free to choose between alternative capital/labour/operating mixes they are ultimately constrained by their obligation to deliver the outputs at the specified cost. Chief executives can have equal confidence that they can hold their managers similarly accountable.

The extent of delegation from a chief executive to his or her managers is dependent on the authority the chief executive has in the first place. In New Zealand this delegation is extensive. It includes the authority to hire and fire staff and set wage rates. It also includes complete authority to choose between permanent or temporary staff or short term consultants. Chief executives also have authority to reallocate their budget as they see fit between personnel and operating items and to buy and sell assets provided that they do so within the capital limit established by their balance sheet.

The degree of delegation from chief executives to their managers varies from department to department but typically includes a global operating expense delegation and a more limited capital delegation.

**Performance incentives**

The performance management system deliberately attempts to create strong incentives on managers to deliver the performance required of them. This occurs in a number of ways.

The performance agreement system creates a formal process to define and agree performance expectations each year. At the end of the year formal performance assessment systems require performance to be assessed against the outputs and financial performance specified in the performance agreement.

Most departments operate a performance pay system whereby remuneration is linked to the performance agreement/assessment system, In some departments up to 1 5% of salary is performance related. In addition chief executive are able to pay staff bonuses from any financial surpluses generated by the department.

The budgeting and reporting systems arc deliberately aligned with the performance requirements of departments. The budgeting system, for example, allocates resources to outputs rather than inputs. In addition the format of budget reports and actual result reports mirror each other so that expected and actual performance can be easily compared.

Departmental managers are expected to manage all their resources and costs. This includes depreciation and the cost of capital invested in departments. The latter is allocated to departments by way of a capital charge which is like a combined interest and dividend payment calculated on the basis of the net assets of the department.

The capital charge creates an incentive for managers to optimise their use of capital. If a department is able to better utilise it assets, sell unneeded assets, and return surplus capital to the government, its capital charge will reduce. It can then use this saving to fund additional personnel or operating expenditure. In this way it makes the opportunity cost of capital transparent to managers and encourages them to increase capital productivity.

**Requirement for high quality reporting**

The fourth component of the New Zealand public sector management system is the provision of regular high quality reports on the performance of departmental managers. These reports cover the two dimensions of performance outlined above: output delivery and financial performance.

The financial performance reporting typically takes the form of a set of financial statements. These look similar to a commercial set of financial statements and normally consist of a:

- statement of accounting policies
- statement of financial performance (operating statement)
- statement of financial position (balance sheet)

- statement of cash flows
- statement of movements in equity
- statement of commitments
- statement of contingent liabilities
- full set of notes.

Although the financial reports look similar to a commercial set of accounts this does not necessarily mean that they should be interpreted the same. For example, the fact that the operating statement reports a surplus or deficit does not imply that the department has, or should have a profit maximising objective. Rather, it reflects that fact that even in the not-for-profit sector, the difference between revenue and expenses is still an important measure of an entities financial performance.

It is usual for departments to provide monthly financial reports and quarterly output delivery reports to their Minister. Departmental annual reports, which are tabled in Parliament include a full set of audited financial statements and an audited statement of service (output) performance.

Internal reporting within departments follow a similar pattern. Monthly financial reports are prepared for each responsibility/accountability centre in the department. It is also usual for monthly output cost and quarterly output delivery reports to be produced for internal management purposes.

**The role of accrual accounting**

Accrual accounting clearly has an important role in this management system. Indeed accrual accounting is necessary for managerial performance to be measured and assessed in the way described above. For example:

- full costing of outputs requires accrual accounting. Cash accounting fails to record the use of significant non-cash resources such as depreciation, cost of capital, and non-salary personnel entitlements.
- financial performance can only be accurately measured if operating and capital expenditures are properly distinguished. Accrual accounting does this while cash accounting does not. Further accrual accounting provides comprehensive information about the assets and liabilities of the department, the management of which is an important part of the financial performance of a chief executive. In the absence of an asset register and balance sheet, managers have very little information to manage assets by.

In short accrual accounting provides the information necessary for the level of financial management required of modem public sector managers.

Accrual accounting has been used in New Zealand because it provides better information for managerial decision-making and accountability. Accrual information is superior to cash data because it provides information about all resources used, not just cash expended. Similarly, it separates capital and operating flows which in turn provides a better picture of the underlying financial position of the entity. Thirdly accrual accounting reports assets and liabilities, thereby focusing management attention on issues such as asset utilisation, working capital management, and liability management.

Accrual accounting can be particularly powerful when part of an integrated performance management system because it allows the various elements of departmental performance to be more clearly measured.

In New Zealand two dimensions of performance have been distinguished: the delivery of services (outputs) and financial performance. Accrual accounting is necessary to adequately measure both of these dimensions. It allows the full cost of outputs to be established and, where appropriate compared with the cost of similar outputs produced elsewhere. It also ensures that the financial performance of the department is measured in a comprehensive and accurate manner.

At the end of the day accounting systems, and the information they provide, are merely managerial tools. Whether they are successful tools will depend on whether they are an integral part of the management system. Whether that is a performance management system will depend on whether it clearly defines the performance expected of managers, provides them the authority they need to deliver that performance, encourages them to deliver it and then holds them accountable accordingly.

## THE BIG SHIFTS:

### For politicians and for public servants

The performance management model and the performance and purchase contracts that flow from it are premised on the basis that:

a) the Executive is capable of and willing to set out their overriding strategic objectives
b) individual ministers, consistent with that overriding strategy, are able to articulate as principals the clear objectives for their agents to follow
c) ministers will take responsibility for specifying those objectives and evaluating their achievement
d) managers will be made to manage and be held accountable for the production of the defined outputs
e) behaviourally ministers will confine themselves to strategic control and leave the execution issues to accountable managers

This involves a huge shift in democratic accountability. Politicians in many countries count on gaining influence over administrative action and seek to involve themselves in detailed administrative decisions. This tendency to micro-mange, or more bluntly put to meddle, sees politicians take control over inputs especially budgets. The modern catch cry that governments should steer, not row, is against the grain of many politicians.

Likewise many public servants operate in a vacuum and regard their “empires” jealously. They are more accustomed to operating solely in their own silos, than they are to interacting strategically with other agencies of the state. Silo rather than strategic behaviour most certainly compromises the quality of outcomes for citizens. Progress on breaking the cycle of dependency, installing welfare to work regimes, dealing with drugs and delinquency, achieving crime reduction or building functional families cannot be achieved if policy and programmes are developed in isolation. There are undeniable linkages between child poverty and educational achievement, unemployment and crime, health and income.

Politics and public policy must reflect these linkages. The shift from rule based input controls to strategic control ensures that these vital linkages can be made; that strategic coherence can be displayed across all policy, structures, budgets and programmes.

## WHERE THE RUBBER HITS THE ROAD:
## The political choke points

**Management needs governing**

The then Minister of State Services and subsequently Prime Minister of New Zealand, the Rt Hon. Jenny Shipley, put her finger on the major pressure points in the New Zealand model when she remarked in 1997:

> "Again, put bluntly, every single performance failure that winds up in the Executive Wing of Parliament Buildings peels away a layer of Ministers' collective confidence in the structures and systems of the State sector.
> They also damage the public's confidence in our collective stewardship and accordingly the successes, however impressive and numerous they may be, tend to count for little when a Minister is facing a battery of cameras and microphones and a jostling throng of journalists who fancy they have caught a whiff of blood." *[9]*

Management cannot be de-coupled from the political process

**Government needs managing**

To be effective Ministers need to move beyond their patch and start to think in terms of collective strategic control. Together they need to articulate a coherent vision for their nation and then back their judgement by translating that vision into concrete performance objectives and instituting a system of cross portfolio co-ordination.

The quest for the achievement of a competitive economy, a computer literate population, a healthy society and a safe and secure environment is going to take much more than the individual efforts of the Minister of Finance, the Minister of Education, the Minister of Health or the Minister of Police. Working in a "team of believers" is a foreign concept for many Ministers. Singing from the same sheet is a novel and uncomfortable proposition.

The Ministers have to recognise where their comparative advantage lies, and distinctly where it does not. Ministers by definition are elected to take strategic leadership. That's their responsibility and that has to be their accountability. Ministers need to subject to close and searching scrutiny the linkage between the outputs they are purchasing and the outcomes they say they want to achieve.

Ministers need to critically examine the interventions made and goods and services provided, and ask the hard questions as to whether those interventions advance the outcomes sought, and whether the goods and services involved are truly public goods.

Having set the strategic objectives, Ministers then have two more critical tasks; to determine precisely the outputs they wish to be supplied, and to install a performance management regime to ensure that officials are accountable for the production of those outputs. It is in the interests of Ministers to properly observe the boundaries between decisions on strategy [their job] and execution [the job of management]. Ministers should not fall into the trap of "having a dog and barking as well". In other words Ministers need to recognise their limitations. They possess neither the management competence, nor information to second guess their management by seeking to substitute their decisions for those of their officials at the input level.

## LESSONS FROM THE NEW ZEALAND EXPERIENCE
## Enhancing and sustaining the reforms

Modernising public sector management is a cause that ought to be “beyond politics” in many senses. Whether the Government is of the so called “right” or the so called “left” is really irrelevant to this cause. What matters to all modern politicians is that they should have modern management tools at their disposal.

Giving the reforms staying power, giving the system sustainability beyond the swings of the electoral pendulum will require a number of adjustments to both the conduct of politics and management practice. Professor Shick put it well when he observed in his review:

> “However, as with any leading edge technology, it may now be time to ‘debug’ elements which have not worked as well as anticipated.” *[10]*

At the conceptual level the performance management model is well anchored; but at the implementation level there has been, unashamedly, a “learning by doing” approach. Performance and purchase contracts have improved over time from the rather rudimentary efforts on day one. Ministers and Parliamentarians are now more comfortable with budgets expressed in terms of outputs rather than inputs. Public officials feel more like managers and expect that in return for management freedom there will be more rigorous accountability of their performance.

Yet nobody would pretend that the system is performing at the level of its potential. When pushed, politicians are prone to revert to input thinking and actions. Performance and purchase contracts risk becoming meaningless rituals. Public officials are not focussed enough on the link between resources and results, and accountability for under performance is not automatic.

While there is always unfinished business in public policy it is clear that significant performance gains can be secured by changes in the political process and changes in management practice.

### Re-engineering the politicians

The New Zealand experience in monetary and fiscal policy has demonstrated that a change to the institutional rules, and an insistence on a transparent and accountable process, can radically change the nature of political debate and indeed political behaviour.

In the case of monetary policy the outcome sought was clear – the achievement and maintenance of price stability. The key characteristics of the institutional rules enshrined in law were these:

- operational independence for the central bank
- a singular and defined objective for monetary policy – price stability
- transparent and accountable conduct of monetary policy

The conduct of monetary policy has effectively been taken out of the political arena, with the politicians content that their objective of price stability is best achieved under this institutional framework.

Likewise an institutional framework has been developed to discipline the conduct of fiscal policy. The Fiscal Responsibility Act that I introduced as Minister of Finance in 1993 is a regime with three fundamental features:

- the five characteristics of fiscal responsibility are defined by law
- the Government is required to publish long term and concrete objectives for the critical indicators of fiscal policy – eg prudent debt levels, public expenditure and taxation levels
- the conduct of fiscal policy is made accountable by the requirement for frequent and full disclosure

The Act has radically altered politicians budgetary behaviour. Since the Act has been in force, New Zealand has run six successive budget surpluses, a significant break from decades of deficits. Fiscal responsibility is regarded as the political norm and the requirement to publish fiscal strategy over the longer term has helped to curtail the chronic short termism that generally characterises political decision making.

The issue is whether similar institutional and behavioural changes can be made across a broader range of policy, particularly at the micro level and in the social spheres.

I am encouraged by the dramatic break with bad political habits that the new institutional arrangements have been able to achieve at the macro level. That emboldens me to believe that similar improvements can be made with a further set of institutional innovations:

First the regulatory interventions need a new institutional framework. I would advocate a *Regulatory Responsibility Act* that set out the parameters for proper rule making. Those parameters would typically cover the cost/benefit analysis of the regulation proposed, the transaction cost consequences, the impact on competitive behaviour etc. The burden of proof would effectively be on the regulator to justify the burden imposed in terms of the impact on efficiency with which resources are allocated.

The second institutional innovation I would advocate springs from the recognition that the accumulation of human and intellectual capital is even more vital to a nation's development ambitions than physical and financial capital. While novel in concept, an *Individual Opportunity Act* would truly focus the mind of governments on their responsibility to create a climate for individual opportunity and well-being. This Act would have to be bold in concept and endeavour to identify the characteristics of opportunity and well-being:

- Access to education of an international standard. The emphasis would be on securing access, rather than assuming that the State would own and run the education system. This could be achieved by ensuring that parents and pupils have choices and that the funding should follow the pupil.
- Access to technology of an international standard. The emphasis would be on ensuring through privatisation and deregulation that technology was in competitive supply
- Access to decent health services. The emphasis would be on the competitive supply of these services, with the State shouldering its public health and regulatory [hygiene and food safety] responsibilities

- Access to social infrastructure. The emphasis would be on ensuring the availability of income replacement and social services where age or infirmity prevented self-supply. No assumption would be made that direct public provision was involved as the norm, although that may be the default position.

The benefit of a law such as this is that it would require politicians to be explicit about their opportunity and well-being objectives. Further, there would be the institutional discipline of having to match the interventions chosen and the resources deployed with the actual results achieved. Counter productive interventions or expenditures would be more quickly revealed and better alternatives more readily adopted. The process of monitoring outcomes and testing value for money questions would be greatly advanced, with services to citizens better assured.

A credible commitment to universal education access and high quality education services is just as vital to a nation's development as a credible commitment to low inflation.

**Re-engineering the political processes**

Different institutional frameworks will require different political behaviour. Traditionally the Executive is led by the President or Prime Minister who in turn allocates portfolio responsibilities along conventional lines – Minister of Finance or the Economy, Minister of Education, Minister of Agriculture, Minister of Justice and so on. Such allocations encourage "silo" behaviour by Ministers and only rarely is collective wisdom brought to bear on cross-cutting issues – eg the link between dysfunctional families, substance abuse, educational failure and crime. Typically four Ministers would each have jurisdiction and typically the individual at risk will fall through the cracks.

Cross-cutting issues call for cross functional Ministers and teams. The classic outcomes most nations want to achieve are grouped around:

- Economic progress
- Individual opportunity and well-being
- Security of self and the nation
- Safe and attractive environment
- Enjoyment of individual, civil and political rights

Ministerial teams should be clustered around these issues. Ministers will then be better placed to ensure that all the interventions underway or contemplated are consistent with advancing the stated objectives.

Once in Ministerial clusters, strategic coherence across the Government can be better assured, and trade offs made more explicit. For example, social well-being will be most surely jeopardised by failure to progress economic performance; and again persistent budget deficits will most surely handicap the ability to invest in education or social service infrastructure.

New Zealand has taken some recent steps to organise Ministers in this fashion and the experience will be worth monitoring. As Ministers become more comfortable with working in this environment, and some early successes are secured, so their level of confidence in this regime will grow.

**Lifting the public sector management game**

Having bureaucrats see themselves as managers is of itself a very big step. But two things matter if these managers are to do well. First talented people must be attracted to the public sector; and second, there must be the right sort of incentives for performance. Hierarchies that stifle initiative not only snuff out innovation, but snuff out good people. While the public sector managers should not enjoy "goal" independence – it is the job of the politicians to set the objective – they should enjoy operational independence with strong accountability.

Where there is reform regression, as is evident in New Zealand currently following the change of government in late 1999, there is the risk that the boundaries between goals and operations will not be respected. Talented managers sense this, and have two choices – to suppress contrary advice or to exit. A collapse of capacity is every bit as worrying where the cause is managerial fright or flight, as it is where the cause is managerial corruption.

The old adage "if you want monkeys, pay peanuts" is unhappily true in many public sectors. The Singapores of this world who pay their politicians and their advisers on a par with the private sector rewards they might expect, are the exception not the rule. "Psychic" income, the individual and civic pride at contributing to the advancement of the public interest, will only go so far to fill the gap between public and private rewards.

So long as rigorous initial efforts have been made to confine the State to its truly core functions, and to ensure that where the State does have a role, the intervention is appropriate and finances are expended on a value for money basis, then there can be no objection to recruiting and incentivising the best talent to get the job done in the public sector.

There is another side to the coin of reward for good performance, and that's penalty for poor performance. Just as it is appropriate that there should be incentives and rewards for high levels of performance, so too must there be credible, readily available and applied sanctions for chronic under-performance.

## CONCLUSION

New Zealand has developed a useful tradition involving the preparation prior to a general election of a briefing document to be submitted to the duly elected incoming government. These briefs are of varying quality ranging from the ground breaking work on government management reform by the Treasury in 1987 *[11]*, to the rather more factual, less policy laden briefs in 1999. Nevertheless they are an unparalleled opportunity for a government agency to stand back from the fray and conduct a sober stock take of what works, what doesn't, and what could be improved.

The Treasury briefing to the incoming government in 1999 gets to the heart of the public sector management issues in this way:

*Public sector management – the business of government*

- Direction setting – leadership, outcomes
- Policy analysis – effectiveness
- Delivery – efficiency, outputs

The pyramid is a symbolic representation of the relationship between Ministers and government agencies, between outcomes, policy advice and outputs. At the peak is the Government which sets out the outcomes it seeks from policy. The second layer represents the policy agencies and their advice. At the base are public services, ranging from schools to tax collection. The question for the incoming Government is, just how effectively are the public sector's outputs contributing to achieving the desired outcomes? The challenge will be to devise programmes and evaluative techniques enabling that to be measured. *[12]*

Ministers can best assure performance for their citizens by leading from the top and critically examining whether effectiveness on the ground is best achieved by a public agency, or better contracted out to a private supplier.

Where the conclusion is that the public sector should be in the service delivery equation, then Ministers need to concentrate on defining and then insisting on the delivery of the types of outputs that best advance the outcomes they seek.

To go further and imagine that the politicians are equipped to manage the programmes themselves, that the politicians should be able to function in a "command and control" fashion over inputs is a fatal conceit on the one hand, and a recipe for failure on the other. Faced with meddling politicians, public sector managers will always have a ready made excuse for non-performance.

The ideal formulae is to make governments govern and managers manage; social and economic performance will be the better for it.

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## Biographical sketch

The Honourable Ruth Richardson was the first Finance Minister [1990 - 1993] in Jim Bolger's National Party Government in New Zealand. She made her name by driving New Zealand's reform agenda forward and laying the basis for the subsequent turnaround of New Zealand's growth and employment performance.

When Ruth was appointed Minister of Finance she inherited an economy in deep recession, a budget forecast to blow out massively and a credit downgrade from an international credit rating agency. Within weeks of taking office Ruth took decisive corrective action with an economic package involving:

- a major fiscal correction
- deregulation of the labour market
- a recommitment to price stability and the 0 - 2% contract with the Central Bank [Reserve Bank]
- early initiatives in redesigning social policy

By July 1993 New Zealand had recorded eight quarters of positive growth and was heading for a fiscal surplus in the 1993/1994 year along with the first credit upgrade in 10 years. On the back of those reforms the economy grew by 20% and New Zealand recorded the highest rate of job growth in the OECD.

Ruth is the acknowledged architect of the Fiscal Responsibility Act 1994, landmark legislation applauded around the world for its success in taming budget deficits and changing the nature of the fiscal policy debate.

Since leaving Parliament after 14 years in 1994, she has been in demand as a policy consultant to governments around the world on streamlining governance, privatisation and comprehensive macro, micro, labour market, public sector and social policy reforms.

Ruth is the Chairman of Cardinal Australia [a subsidiary of the Aoraki Corporation], Chairman of Morningstar Pty Ltd, Chairman of the Pacific Investment Capital Fund [the Kula Fund], a director of the Aoraki Corporation, Immuno-Chemical Products Ltd, Oyster Bay Marlborough Vineyards Ltd, TransAlta NZ Ltd, Wrightson Ltd, and the Reserve Bank of New Zealand [New Zealand's Central Bank]. She was, until the end of 1999, Chairman of Dairy Brands [NZ] Ltd.

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# EXECUTIVE SUMMARY


The twin forces of globalisation and technology are changing our personal lives, dictating our economic opportunities and re-shaping how we function as a society and the way in which we are governed.

In a world of the free flow of people and their ideas, of trade and capital, the sanctions for poor governance and poor quality policy are swift and they are savage.

This paper casts performance in the broadest terms to encapsulate our ambitions as a nation and challenge the ability of the traditional State to achieve those objectives.

The paper contends that the status quo of the big State and unaccountable bureaucracies hasn't worked and is no longer affordable. Governments that don't demonstrate strategic leadership, managers who are not accountable for performance are productive of not one but three deficits:

- governance deficits
- performance deficit
- fiscal deficit [of course!]

This paper is designed to:

- Re-examine the basis for and effectiveness of government interventions
- Diagnose the causes of failure in the traditional bureaucratic model
- Identify the conceptual basis and key characteristics of a performance management regime
- Describe and assess the new management tools that help ensure accountability for performance
- Focus on the big shifts that occur at both the political and official level when the system moves from rule-based to strategic control
- Isolate the pressure and "choke" points for politicians in the performance management regimes
- Draw some lessons from the New Zealand experience that will serve to enhance and sustain the reforms

The paper concludes that to secure further dividends from a public sector performance management regime, the next generation of reforms will require attention to institutional and management deficits. First, new institutional frameworks are necessary to "re-engineer" the politicians and the political process; Second, a new culture of innovation in the ranks of public sector managers is necessary and will require greater attention to recruiting and incentivising talented and professional people.