SECTION 2 MAKING GOVERNMENT MORE EFFICIENT

2.1 Improving productivity

Productivity improvement lies at the heart of virtually all the public sector reform measures that have been implemented over the past decade. The State Sector Act (1988) and the Public Finance Act (1989) were aimed at improving public sector performance as was the restructuring of the public sector into such new entities as State Owned Enterprises, Crown Agencies and Policy Ministries.

A particular initiative in improving productivity: the Public Service Task Force on Productivity

This entry looks at a project undertaken by a Public Service Task Force on Productivity to bring together in a single document instances of productivity that could be of relevance throughout the public sector.

A simple definition of productivity is that it is a means of increasing the quality, quantity and relevance of the work done for a given quantity of resources.

For organisations facing commercial pressures productivity is ultimately a matter of survival. While the imperatives facing public sector organisations are often less clear cut, in the New Zealand context, the public sector has also had to face a number of challenges. As a result of substantial public debt, on-going fiscal restraint has been necessary. Most areas of the public sector are having to maintain outputs with either a constant or declining real level of resources. In addition, public sector reforms aimed at enhancing accountability and financial management performance (the State Sector and Public Finance Acts) have added to the pressures on the public sector to improve productivity.

In the public sector context productivity can be considered at three levels:

- productivity change for the service as a whole, or for a particular agency;
- productivity change for specific activities within agencies, (e.g. measuring changes only in one or more sections of the organisation);
- productivity change that comes from particular initiatives.

The Public Service Task Force on Productivity was established in 1991 and was drawn from the employer parties – government departments and the State Services Commission (SSC) – and the public service union – Public Service Association (PSA). The handbook on productivity which the Task Force prepared, "Doing It

Better, Doing It Right", was the first comprehensive study of productivity within the public sector. The handbook contained a series of case studies on productivity drawn from both the public and private sectors. The structure of the handbook was as follows:

Section 1	The purpose of the project and the lessons derived from it.
Section 2	An overview of productivity initiatives.
Section 3	Case studies of organisations undertaking initiatives.
Section 4	Appendices covering particular methods of improving productivity, issues of productivity measurement, and references.

The Task Force did not interpret productivity in the narrow sense of improving the efficiency and effectiveness of operations through cost or staff cutting, but endeavoured to give the concept a human focus. The emphasis was on achieving a co-operative approach to productivity improvement. The intention was to seek benefit for all the stakeholders in public sector productivity in order that:

- the tax-paying public received value for money;
- the Government's policies were achieved;
- the public received a quality service;
- managers achieved agreed objectives;
- employees received recognition and job satisfaction.

To illustrate the diversity of topics covered in the Task Force's report the following list sets out the subjects and organisation for each of the case studies in section 3:

(i) Accommodation Requirements: Department of Labour
(ii) Goal Identification and Culture Change: Department of Labour
(iii) Multi-skilling: Ministry of Foreign Affairs and Trade
(iv) Productivity in the Probation Division: Justice Department
(v) Quality of Policy Advice: Ministry of Commerce
(vi) Quality of Service: Accident Compensation Corporation
(vii) Quality of Written Material: Department of Health *(Write Right* project)
(viii) Quality of Written Material: Department of Health *(Ministerials* project)
(ix) Technological Change: Customs Department
(x) Technological Change: Government Superannuation Fund
(xi) Total Quality Management: Ministry of Transport-Marine Division

(xii) Total Quality Management: Air New Zealand-Logistics Centre.

The aims of preparing the handbook were:

- to identify ways in which productivity could be improved in the public sector to benefit employers, workers and the public;

- to identify the factors which inhibit or promote productivity in particular areas of the public sector;

- to examine productivity improvement experience in the public and private sectors, both nationally and internationally;

- to bring together the employees' union (the PSA) and the employing departments in a partnership for productivity improvement;

- to provide a mechanism to enable organisations to learn from each other's experience.

In producing the report, the first step undertaken by the Task Force was to identify from a literature survey factors that had been found to contribute to productivity. This was followed by a survey of departments and a number of organisations outside the public sector to locate any recent work they had done that related to the productivity factors. Based on the responses received it was possible to select the 12 case studies for inclusion in the handbook. The Taskforce was convened in 1991 and produced its report by April 1992.

In summary, the major lessons to emerge from the project were familiar but worth restatement:

- Management and employees must work together towards common goals.

- Improving productivity is not a one-time exercise but a continuing and comprehensive process.

- Real and lasting improvement only occurs when the whole organisation is participating in the process.

- Significant productivity improvement requires commitment, time and energy. These factors are difficult to achieve when people in an organisation are preoccupied with other issues such as restructuring.

- Almost any work place change is likely to encounter differences of opinion or disagreement. This should be acknowledged and addressed.

- Relatively few organisations studied had systematically monitored the process of productivity improvement. It is important that organisations take stock and evaluate the success of the initiatives they are taking.
- External consultants can make a useful contribution to productivity improvement provided management maintains a close oversight.

Supporting material

(i) For detailed information on the case studies and the particular lessons to be derived from each of them, the handbook itself should be consulted

(ii) "Doing It Better, Doing It Right", Public Service Taskforce on Productivity, 1992, State Services Commission, Wellington

2.2 Selecting appropriate organisational structures in government

The New Zealand public sector has undergone a radical restructuring since 1984. The changes have affected the size, structure and organisational relationships in the public sector. The purpose of this entry is to give an overview of the reforms, many of which are the subject of separate entries in this publication.

The major areas of reform can be summarised as:

- liberalisation and deregulation of the New Zealand economy as a whole;
- transformation of government-owned trading enterprises, within the core public sector, into corporate, profit-driven organisations;
- sale to the private sector (privatisation) of formerly state-owned trading enterprises;
- separation of policy advice from service delivery functions, for many departments within the core public service;
- replacement of the position of *permanent head* of department by chief executive with specific power to act as the employer of departmental staff;
- appointment of chief executives on contract for terms not exceeding five years;
- definition and documentation of the relationship between Minister and chief executive in a formal performance agreement;
- major restructuring in many sectors including defence, health and education. Overall public service staff numbers have fallen by approximately 50 per cent since the mid-1980s;
- introduction of a package of financial management reforms to the public sector including accrual accounting and charging for the capital invested in Crown organisations.

The context for change

New Zealand's reform programme has been driven by concern with the growth of public expenditure, a perceived need to improve the effectiveness with which these resources were used, a belief in the market as the best determinant of allocative efficiency, and the use of the disciplines of the market environment wherever feasible to create competitive conditions that would promote improved productivity.

In its briefing material for the incoming Government in 1984, the Treasury, which played a pivotal role in the reform process, highlighted the poor performance of the public sector as contributing factor to New Zealand's overall economic performance. In effect, this document and its successor, the 1987 briefing paper, provide a blueprint for the reform process.

Treasury criticisms were stated as follows:

- most departments have no clearly defined goals;
- most departments have no clearly defined management plan;
- there are few effective control mechanisms to review the performance of departments in meeting their output requirements;
- departmental managers have little freedom to change the way their department operates to meet their goals, especially in staffing matters. They lack the autonomy they need within an overall expenditure limit to use their judgement to produce the best outcome;
- too much emphasis is placed on the control of inputs;
- there are no effective review mechanisms for dealing with poor performance in senior management within departments.

The timing and nature of public sector reform must be placed within the context of a New Zealand economy which, before 1984, had been characterised by large fiscal deficits, a substantial overseas debt and a history of relatively low growth. After 1984, reforms in virtually every other sector of the economy led inevitably to concern with the effectiveness of the public sector as a whole. In the year ending 31 March 1984 the public sector accounted for 22 per cent of GDP, 28 per cent of gross capital formation and government expenditure including transfers was 39 per cent of GDP. Inefficiency in this sector obviously imposed a major burden on the economy as a whole.

Implementing change

The reform process followed two main strands:

- The first phase of reform entailed the transfer of state trading organisations from the core public sector into commercially driven public corporatisations as State-Owned Enterprises (SOEs).

- The second phase entailed reform of the remaining core public service by means of the State Sector Act and introducing financial management reform with the Public Finance Act.

The speed of implementation of reform in New Zealand was heavily influenced by factors such as a three-year electoral cycle, the relatively small size of the society, and the nature of the Parliamentary system. In addition, Government considered there was an urgent need to address the fiscal deficit and open the economy to competitive forces.

The broad sequence of the reforms is marked by the three principle legislative milestones.

State Owned Enterprises Act 1986

The commercial aspects of departmental activity were seen as having the greatest potential for improved performance. The corporatisation, or State Owned Enterprises (SOE), policy had five main elements which were that SOEs should:

- have clear and commercial objectives;

- operate under conditions of competitive neutrality;

- have greater managerial flexibility and authority over key decisions;

- have their performance effectively monitored;

- have any non-commercial activities, undertaken at the request of government, the subject of explicit subsidy.

Initially nine SOEs were created from former government departments on 1 April 1987. Subsequently other SOEs have been created.

Privatisation has been a further development. On a case-by-case basis two key principles determined whether retaining ownership in the public sector was merited:

(i) Would sale generate more for the taxpayer than continued public ownership?

(ii) Would sale make a positive contribution to government's economic and social policies?

Privatisation has now been applied to 22 formerly publicly owned enterprises.

State Sector Act 1988
This Act took effect on 1 April 1988. A key premise behind shifting state trading organisations out of the core state sector had been to achieve better commercial performance through new incentives for management. A similar approach lay behind the State Sector Act.

The main features included:

- Changing the relationship between ministers and permanent heads (renamed as chief executives or CEOs). CEOs are appointed on contracts of up to five years;

- Chief executive performance is now subject to a formal appraisal system conducted by Treasury and the State Services Commission (SSC);

- The former centralised employment system run by the SSC was replaced. The chief executive of each department became the employer of all staff within the department;

- The industrial relations regime applying in the public sector was closely aligned to the private sector.

Public Finance Act 1989
This was the third and last component of the public sector reforms. Underlying the Act was a revised way of conceiving performance in the public sector. Financial management reform in New Zealand has been based on two main elements:

(i) That there is an important distinction between the interest government has in the goods and services it purchases from a department (the purchase interest) and the efficiency with which the department operates (the ownership interest).

(ii) That there is a need to distinguish between outputs and outcomes of public sector activity, government departments being accountable only for the delivery of the former. Outcomes are the impacts on the community of the government's actions and these may be affected by a wide variety of factors.

These distinctions have been applied to the methods of appropriating finance, the reporting regime put in place and the way the policy advice function has been organised.

Under the Public Finance Act appropriations must be framed in terms of costs incurred in the production of outputs. The Act also established new mechanisms and content for reporting performance. The main focus of the requirements is the annual report and accompanying financial statements. While outputs constitute the basic building blocks of parliamentary appropriation, the process of refining the specification of outputs has been an on-going one. The 1991 Budget process was the first in which all departments operated under the new systems.

The role of policy advice is made explicit under the new financial management regime.

Supporting material

(i) Scott G, Bushnell P, Sallee N, 1990 "Reform of the Core Public Sector: The New Zealand Experience", *Public Sector* Vol.13, No.3, September 1991

(ii) *The New Zealand Government Management Reforms 1987-1990*, State Services Commission, 1991, Wellington

(iii) Steering Group, 1991 *Review of State Sector Reforms, State Services Commission,* Wellington

(iv) *Economic Management,* The Treasury, 1984, Wellington

(v) *Government Management*, The Treasury, 1987, Wellington

2.3 Corporatisation and divestiture

By OECD standards, government has played a pervasive role in the New Zealand economy. As well as providing a wide range of administrative and social services the government came to own and operate a wide range of traded services. In 1984 government spending accounted for over 40 per cent of GDP and 31 per cent of employment. Most of the state trading activity was conducted by departments and was subject to close central control and parliamentary scrutiny in detail over activities and expenditure.

Since 1984 New Zealand has experienced widespread deregulation in many sectors of the economy including the labour market. This trend towards economic liberalisation was accompanied by a major restructuring of the public sector. This entry examines one aspect of New Zealand public sector reform, the corporatisation, and in many instances the subsequent privatisation, of public trading enterprises.

The mechanism developed to facilitate the divestiture of the state trading agencies was the State Owned Enterprise Act of 1986. In many cases government-owned enterprises, in fields such as banking, forestry, insurance, transport, communications and broadcasting, were transformed from departmental into corporate form. Corporatisation was often subsequently followed by full-scale privatisation (over 20 government businesses have been sold since 1988).

The context for change

In the decades prior to the mid-1980s, New Zealand productivity and economic growth had been poor relative to the OECD as a whole. The government that came into office in 1984 initiated a comprehensive series of reforms designed to free up the economy, reduce the role of government and promote sustainable economic growth. The move to corporatise organisations that had previously been government trading departments or enterprises was consistent with a government objective to open up many sectors of the economy to internal and external competition. Promoting competition in as many fields as possible was seen as a way of enhancing New Zealand's overall economic performance.

Before the corporatisation process began it is estimated government trading enterprises collectively accounted for about 12 per cent of GDP and 20 per cent of the gross annual investment in New Zealand.

Before corporatisation, many organisations combined a mixture of commercial and social objectives. A major aim of the State Owned Enterprises Act of 1986 was to give SOEs a clear commercial mandate. Accordingly, Section 4 of the Act required SOEs to operate as successful commercial businesses. This was taken to mean that they should emulate the efficiency and profitability of their private sector counterparts.

The basic imperative, i.e. market failure, that had caused New Zealand governments in the past to acquire trading activities in a wide range of sectors no longer appeared valid. Instead, governments became more concerned with *government failure* or poor productivity that occurred when commercial activities were undertaken by government-owned enterprises.

The theoretical arguments in support of corporatisation were based on the presumption that efficiency could be improved by approximating the operating conditions that applied in the private sector. Furthermore, there was a widespread perception that, relative to private sector performance, many government trading enterprises were poorly managed and inefficient.

The impulse for privatisation, which developed after corporatisation was under way, was strongly influenced by:

- the desire to use the proceeds of asset sales to close the fiscal deficit and reduce the level of public debt;

- a conviction that for some organisations the full efficiency gains would not be achieved until the entity was entirely outside the state sector.

Implementing change

Before the reforms initiated in the mid-1980s the New Zealand public sector was characterised by a wide range of functions. Government agencies could be grouped into three broad categories:

- core or non-trading departments such as Treasury, Defence, and Health;

- trading departments or enterprises such as New Zealand Railways, Air New Zealand, and New Zealand Post;

- Local Government.

Prior to corporatisation, most public trading enterprises were government departments and their employees public servants. In 1985 the Minister of Finance outlined five key principles for the re-organisation of state trading enterprises:

(i) Non-commercial functions would be separated from major state trading organisations;

(ii) Managers would be required to run them as business enterprises;

(iii) Managers would be responsible for using inputs, for pricing, and for marketing their products within performance objectives set by ministers.

(iv) The enterprises would be required to operate without competitive advantages or disadvantages, so that commercial criteria would provide an assessment of managerial performance;

(v) Enterprises would be set up on an individual basis depending on their commercial purposes, under the guidance of boards modelled on the private sector.

The main vehicle for the re-organisation of state trading enterprises was the 1986 State Owned Enterprise Act. The Act provided for the appointment of a board of directors accountable to the Minister of Finance. If government wanted a State Owned Enterprise (SOE) to provide a non-commercial service it had to contract to do so. The SOE model can be approximated to that of a publicly listed company. By 1989 fifteen SOEs had been created.

In 1987 the Government decided that, in future, public trading enterprises would be expected to fund their spending from unsubsidised private sector capital sources and that they would be expected to pay taxes and dividends.

Although many countries have undertaken corporatisation and privatisation programmes, New Zealand's programme can be distinguished by its comprehensiveness and speed.

The process of corporatisation should be seen as a variety of processes rather the application of a standard formula. In general, the process involves setting up an establishment board or steering committee to oversee the transition. The variety of routes to corporatisation reflect the diversity of organisations under which the government traded. Apart from departments, there existed government-owned limited liability companies (e.g. Air New Zealand) and different types of public corporations covered by specific legislation.

Because of the diversity of organisational forms from which SOEs were created, it is difficult to generalise about the method and speed of the transition to SOE status. In the more straightforward cases, transition was achieved within two years. In other cases the transitional arrangements were complicated by a variety of factors such as valuation of assets.

Similarly, for the privatisation process a range of routes and methods were adopted, depending on conditions in the marketplace, fiscal considerations and political factors influencing sale. Privatisations have tended to follow one of the two following routes:

- an equity route where shares were sold in clearly defined commercial organisations;

- an asset route that entailed selling assets because of the less commercial nature of the organisation;

The process of privatisation has proved more controversial than corporatisation. Particularly in the initial years, mistakes were made in privatisation as government and the public service gained experience. In the privatisation of assets, as long as safeguards were installed, there was no restriction on foreign ownership.

Corporatisation should be viewed as one aspect of the economic liberalisation of the New Zealand economy that occurred in the period 1984-94. This transformed an economy characterised by heavy protection and large-scale government intervention to one in which intervention was minimal and large parts of the public sector had been either corporatised or sold to the private sector.

At the outset of the corporatisation process the aim was to reform publicly owned enterprises so they would perform more efficiently and make a reasonable rate of return rather than being a drain on the public purse. The transfer of these enterprises into the private sector through the process of privatisation was a separate idea that emerged subsequently.

New Zealand commenced its process of corporatisation in the mid-1980s and by the end of the decade the process was substantially complete. Although most of the large-scale privatisations, involving organisations such as Telecom, New Zealand Rail and Air New Zealand, have been completed, privatisation is on-going.

Supporting material

(i) Bollard A and Mayes D, 1991, *Corporatisation and Privatisation in New Zealand*, New Zealand Institute of Economic Research, Wellington

(ii) Bollard, A, Buckle, R 1987, *Economic Liberalisation in New Zealand*, Allen and Unwin, Wellington

(iii) Duncan, I, Bollard, A, 1992, *Corporatisation and Privatisation – Lessons from New Zealand*, Oxford University Press, Oxford

(iv) Zino, M. 1992, *The Effects of Post-1984 Deregulation in New Zealand,* New Zealand Banker, Wellington