

Public Sector Performance – the New Zealand experience

Speech delivered by
Fergus Welsh, Chief Financial Officer
to CPA Australia Conference, Melbourne

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Hello, I'm Fergus Welsh, the Chief Accountant and Chief Financial Officer at the New Zealand Treasury. Thanks for coming along to hear what is happening the public sector performance space in New Zealand, and thanks also to CPA Australia for hosting this conference.

The conference promotional pamphlets said my presentation would cover some of the work the New Zealand Treasury is doing to re-shape the public sector. But before I can tell you about what we are doing, I'll give you a quick update on the economic impact of the earthquake that struck Christchurch 16 days ago.

Canterbury Earthquakes

- Two big quakes: Sept 2010 and Feb 2011
- Thanks to Australia for immediate help
- Canterbury region is 15% of NZ economy
- NZ\$15b estimated damage and NZ\$15b estimated impact on GDP growth over 5 years
- Highlights importance of resilient public sector

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The scale of human loss in this disaster is of a magnitude that means nothing matches its importance for New Zealanders right now. As a Kiwi with family and friends in Christchurch (all of whom are safe and well) I have been overwhelmed to hear and see the extent of support that our neighbours over here in Australia, and others from around the world, have provided to Christchurch at their time of need.

The manpower and money that Australia has so willingly provided is deeply appreciated by New Zealanders. Your support has been a real demonstration of true ANZAC camaraderie and spirit. .

Christchurch has been dealt a terrible blow and its recovery will be slow.

It is important though to note that the Canterbury region accounts for about 15% of the New Zealand economy and while Christchurch city has been badly damaged, economic activity in the region hasn't halted completely – it has just been interrupted and slowed. Economic activity in the rest of New Zealand continues apace.

The earthquake will have a negative impact on GDP growth in the short term but a positive impact once the recovery is in full swing in 2012. Over the 2011 to 2015 March years, GDP growth is expected to be a cumulative NZ\$15 billion lower than it otherwise would have been.

The damage estimate is NZ\$15 billion from the two big recent earthquakes. Except for important infrastructure, the large boost to investment expected from the earthquake recovery work will mainly occur from 2012 onwards.

The events of two weeks ago reinforce the importance of managing the Crown's reserves and balance sheet in order to respond to such events. The public sector financial management approach has been a key enabler to ensure that this can occur, and today I want to outline what initiatives are underway to reshape the New Zealand public sector, to ensure we can continue to leverage off the changes of the past 20+ years.

NZ Public Sector History

- Devolved management structure
- Need clear strategy & leadership
- Treasury has lead role on fiscal matters
- Treasury Chief Accountant role is to develop and implement strategies for improved management of Govt financial resources

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The New Zealand public sector consists of 38 Ministries or Departments, over 100 Crown Entities, and numerous other bodies. We are a nation of only 4.2 million people and we don't have state and federal governments.

New Zealand has a devolved public sector management structure. The Government decides what outcomes it cares most about improving, then the public service provides advice on the best way of meeting those outcomes within available resources.

Responsibility for managing resources clearly lies with public sector Chief Executives, rather than with Government Ministers or central agencies such as the Treasury.

To succeed, the devolved model requires a well articulated strategy and clear leadership from the three central agencies, including The Treasury. Our role is to provide that leadership, particularly in fiscal matters or on policies that have a big impact on fiscal strategy and fiscal outcomes.

As The Treasury's CFO, I also have the role of Chief Accountant for the public sector. My role is to lead the development and implementation of strategies for improving the management of financial resources across government, as well as to improve the quality of Treasury's own management accounting and financial capability.

Professional bodies such as CPA Australia are a key input to improving the skills and knowledge of those involved with improving financial management capability, and I welcome the opportunity to work with your New Zealand colleagues in this regard.

History of Public Sector Finances

- Political decisions dominated financial management until early 1980s
- Radical changes from 1986 to 1994
 - More transparent accounting
 - Fiscal policy based on 5 principals
 - Central Bank independence

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Up until the early to mid-1980s, New Zealand had a poor record in managing public finances. Short-term political considerations often dominated when vital decisions were being made. Then New Zealand made a radical departure from long-standing practice with several pieces of legislation.

The first, in 1986, was the State Owned Enterprises Act, which shifted the public sector's commercial activities into company form. Then the State Sector Act made public sector chief executives accountable to their Ministers for all aspects of their departments. A year later, the Public Finance Act provided the legal framework for financial management reform in New Zealand. It also introduced a requirement for the Crown and departments to report under accrual accounting and generally accepted accounting practice.

Also in 1989, The Reserve Bank Act significantly strengthened the [Central Bank's](#) independence and gave it a mandate to achieve and maintain price stability.

Then, in 1994, the Fiscal Responsibility Act established five principles to govern [fiscal policy](#). The principles included maintaining government debt at prudent levels by running a balanced budget on average over the economic cycle; and pursuing policies that are consistent with a reasonable degree of predictability about the level and stability of tax rates for future years.

When the Public Finance Act was amended in 2004, the requirements of the Fiscal Responsibility Act were merged into it.

This suite of legislation has put a good foundation in place.

Before the global recession hit in late 2008, New Zealand's economy was already in poor shape. Our average annual growth was less than 1% in the three years leading up to the 2008 global financial crisis and we went into recession several months earlier, before just about every other developed economy.

Current Situation

- New Zealand hit by recession before late 2008
- Sluggish, un-balanced growth
 - Tradeable sector shrinking
 - Non-tradeable sector expanding
 - Govt spending growth twice GDP growth

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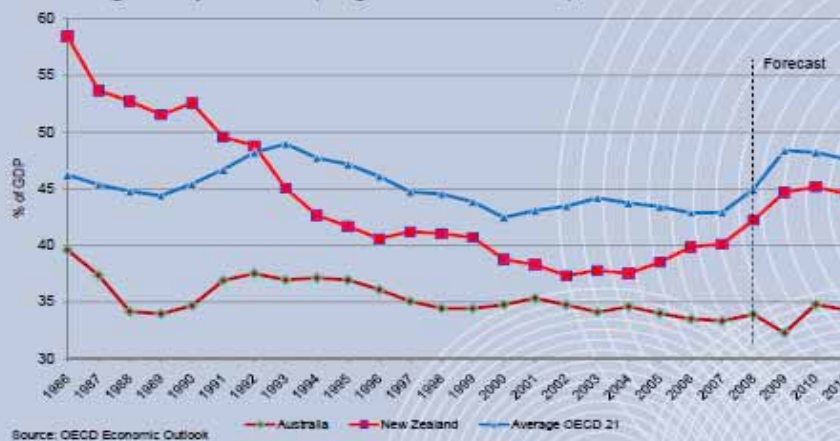
Our track record going back several years shows sluggish and unbalanced growth driven by excessive debt, consumption, and [government spending](#) -- rather than by savings and exports. New Zealand's economic growth in recent years has been badly skewed towards growth in household and government spending.

The tradeables sector (the exports and import-competing industries that are the internationally competitive part of the economy) actually shrank in the five years from 2004 to 2009. There were no net new jobs created in the manufacturing and agricultural sectors for the best part of a decade up to the end of 2009.

Meanwhile the non-tradeables sector, which doesn't bring new wealth into New Zealand, has grown by 15 per cent since 2005.

Government Spending Growth

General govt expenditure (all government levels), 1996 – 2008 and forecasts



Source: OECD Economic Outlook

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And over the same period, government spending ballooned by about 50 per cent - twice the rate of Government revenue growth and twice the overall rate of economic growth.

New Zealand's public sector is a major part of the economy. It is the biggest employer. Core Crown expenses are 35% of GDP.

A really high performing public sector is a vital contributor to the economy and well being of New Zealanders.

Why Performance Matters

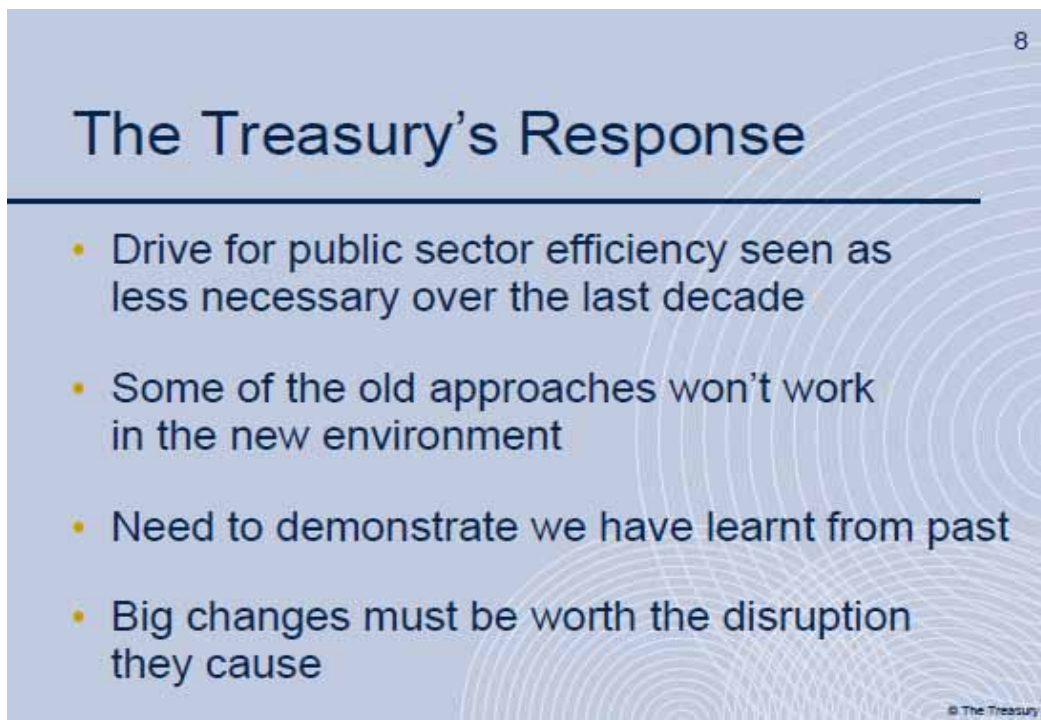
- Quality public sector is vital for society
- Economic performance affected by public sector performance
- Current government very keen to increase public sector performance

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Quality [public services](#) are essential for society to function. Delivering top quality services and regulatory settings at the lowest cost is one of the most important ways the public sector can contribute to private sector productivity, because this leaves money and resources in the tradeable sector.

What the public sector does has a direct impact on everyone in the country but how well the public sector goes about doing its work is vital to economic growth. The public sector must work as efficiently as possible in delivering the right services in the right way, at the right price.

The current Government of New Zealand has made several very firm statements about the need to increase public sector performance.



8

The Treasury's Response

- Drive for public sector efficiency seen as less necessary over the last decade
- Some of the old approaches won't work in the new environment
- Need to demonstrate we have learnt from past
- Big changes must be worth the disruption they cause

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The Treasury agrees that public sector productivity must increase and that we can't get improved productivity across the economy while ignoring the productivity of public sector organisations.

We are looking closely at how well the public sector management system works, including what the management system needs to achieve.

We are looking at the effectiveness of the performance management system and the tools within it, focusing our analysis on:

- **Line of Sight.** That is, ensuring that every single public servant understands what is expected of them, and what individual contribution they make to achieving the objectives of their public sector agency and the wider objectives of the Government.
- **Incentives for performance improvement – i. e.** ensuring that there are genuine and effective consequences for both the good behaviours we want to encourage and the less desirable behaviours we want to eliminate.

- **Using what we learn** about the public sector's performance to inform our advice to Ministers on policy, regulation and spending decisions; and
- **Proportionality**, including reducing the compliance burden and making sure that we have a lean performance management system that gets maximum result with a minimum of bureaucracy.

After the fairly radical moves of the late 1980s and early 1990s, the drive for efficiency in the public sector has been seen as less of a necessity over the last decade. The fiscal environment up until late 2008 allowed for significant growth in the public sector that resulted in a public sector that is not optimally configured for the current [fiscal environment and the demographic and economic outlook](#) that we face.

The changes we need in the public sector need to be more than just one or two tweaks -- or a few incremental improvements. We can't deal with the new global economic environment and the demands of 21st century with old tools, approaches and mindsets.

I don't want to suggest that we are revisiting the fundamentals of public sector management principles -- that isn't the case. But we are looking closely at how to keep those principles relevant and workable.

Some of the changes of the late 1980s and early 1990s have proven their worth, but there were also some controversial approaches and policies that generated enduring negative views. Significant portions of New Zealand society appear to distrust change that may be more readily accepted elsewhere in the world, fearing that experiences of the past may be repeated without the benefit of any lessons learnt.

The Treasury recognises that we need to show that we have learnt the lessons of the past. We need to create well-informed public debate about the difficult trade-offs involved in taxation, superannuation and state asset ownership. And we need to be sure that where we recommend big changes, the results are worth the likely disruption.

Investment Statement

- Focus traditionally has been on new revenue and cash flows
- Crown balance sheet totals NZ\$223 billion
- Capital needs to be used efficiently and placed in priority areas

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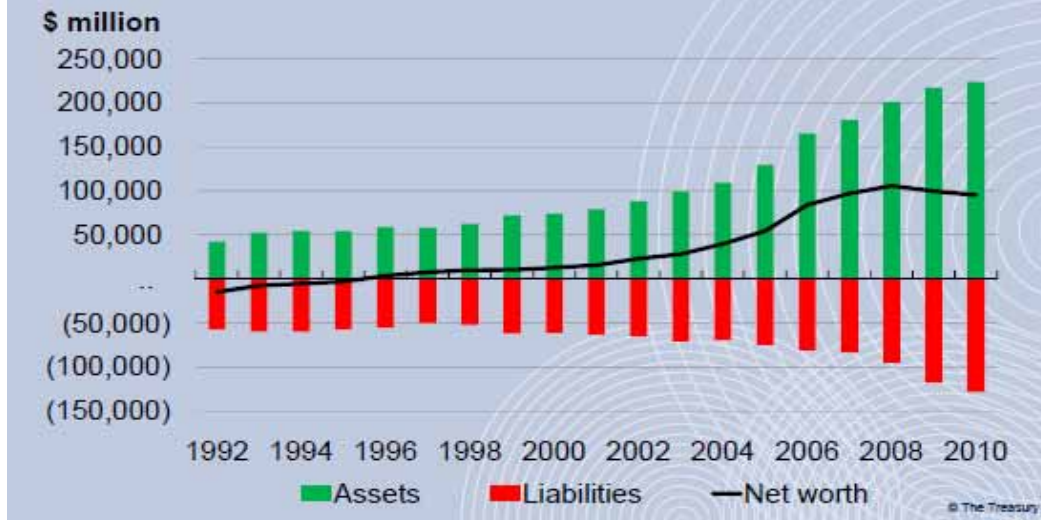
New Zealand's Finance Minister Bill English noted recently that capital spending has been poorly managed by successive New Zealand governments.

The New Zealand Treasury has moved public sector attention beyond just marginal new spending, and we are now also helping public sector agencies to see and understand what they have on their balance sheets.

We are educating the public sector about the need to ensure that not only income and cash flows are well managed over a medium-term timeframe, but that taxpayers' capital is efficiently and effectively utilised over the longer term.

One of the ground-breaking ideas we've launched recently in New Zealand is the [Investment Statement of the Government of New Zealand](#).

Balance Sheet Has Changed



The Investment Statement provides an overview of the significant assets and liabilities on the Crown's balance sheet. It shows how they have changed over time and how the Crown's assets and liabilities are forecast to change over the next five years. The Treasury published the first Investment Statement four months ago, in December last year.

The Investment Statement shows that the Crown, on behalf of taxpayers, owns NZ\$223 billion of assets. The Crown balance sheet is large and stronger than 15 years ago but debt is growing faster than assets. This means that the net worth will continue to decline.

In the current fiscal context, if the Government is going to promote stronger growth in the economy and better, more affordable public services, it is particularly important that Crown agencies get the most value out of existing assets, and that Government is able to redirect capital to where it is needed most and produces most value from a Crown-wide perspective.

Government's Investment Intentions

- Rebuild buffer against future shocks
- Reduce risk exposures
- Sharpen incentives to use capital well
- Introduce private sector capital and disciplines, where appropriate, to lift performance
- Prioritise capital to its highest value use

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The Investment Statement reveals the large amount of Crown investment in assets that happens each year – which is significantly greater than the Government's budget for new capital expenditure each year – and shows where that investment is being allocated. I'm not aware of any other nation or state moving to such a level of transparency.

The Investment Statement poses questions about how well that investment is aligned to the Government's overall economic and social objectives. It also reveals that information on the performance of significant assets is weak.

The Minister of Finance noted recently that the Investment Statement reveals just how many calls there are on Crown capital, with the Crown expected to acquire an additional NZ\$70 billion worth of assets over the next 5 years, spread widely across its operations. Even allowing for depreciation and variability in the value of financial assets, the net increase in Crown assets is expected to be about NZ\$33 billion. A significant proportion of this will be funded from retained earnings generated by the Government's commercial enterprises, or from taxpayers' pockets.

While big ideas such as the Investment Statement can provide important tools and approaches, sometimes incremental change turns out to be far more important than it may first appear too, such as when it affects the foundations of New Zealand's public sector management.

Incremental Change

- Sum-of-the-parts may be bigger than expected if many small changes done
- Back-office costs & efficiency being measured
 - Savings identified
 - Best-practice techniques uncovered
 - Targets can now be established

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When a whole sequence of incremental changes is done the right way, they can make a very significant difference.

The [Better Administrative and Support Services](#) (BASS) Programme is an example of one of these incremental changes that can have a wide-reaching impact. Until recently, there was no systematic or robust measurement of spending by public sector agencies on the back-office Administrative and Support Services that they all use and consume. While some agencies undertook benchmarking on their own accord, we simply hadn't measured how much we collectively spent on vital administrative processes and functions such as finance, legal, IT, human resources or procurement.

It turns out that we've been spending a lot - which we already suspected - and that the quality of services provided has been variable when compared to international best practice. But what we've been able to establish is that some public sector back-offices are far more efficient or effective than others.

The BASS Programme is digging in to why these differences exist in efficiency and effectiveness, with the long-term goal of establishing realistic measures that all public sector agencies should be able to achieve and looking at short term and longer term initiatives that will support this.

Over time, this has potential to not only save hundreds of millions of dollars but also to make the public sector a smoother running machine. Efficient and effective back-office Administration and Support is a foundation.

Performance Improvement Framework

- Focus on core functions – the factory floor
 - Organisational management
 - Delivery of outcomes being sought
- Information from PIF can help CFOs direct resources where needed

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Away from the public sector back-office and on the actual “factory floor” of each agency, the three central agencies are also running a process to measure and influence the performance of agencies and provide a consistent framework to compare them. What is referred to as the [Performance Improvement Framework](#) (PIF), is being used by agencies to drive a series of individual actions that add up to very significant change.

The reviews done for the PIF focus on organisational management and the delivery of their core business areas. The PIF provides a consistent framework from which agencies can be assessed (or assess themselves) across a number of disciplines. These include:

- Government Priorities
- Core Business Areas
- Leadership, Direction and Delivery
- External Relationships
- People Development; and
- Financial and Resource Management

All elements of these reviews are important to a CFO, particularly as the role of CFO is to help shape and interpret / operationalise the core business of any organisation, ensure it is efficient and effective, and that resources are being directed to the highest priorities. The critical area of Financial and Resource Management is at the core of what a CFO has direct responsibility for in many cases.

The critical elements of Financial and Resource Management include assessing:

- Asset Management - How well does the agency manage its assets, and the agency balance sheet, to support delivery?

- Information Management - How well does the agency utilise information & communications technologies to improve service delivery?
- Efficiency - How robust are the processes in place to test for efficiency and make efficiency improvements? How well does the agency balance cost and quality when considering service delivery options?
- Financial Management - How well does the agency manage its financial information and ensure financial probity across the business?
- Risk Management - How well does the agency manage agency risks and risks to the Crown?

Similarly, a [Review of Expenditure on Policy Advice](#) has just been completed, examining how well the New Zealand Government's policy agencies are performing. As with the previously mentioned BASS Programme and the Performance Improvement Framework, the results of this review show that performance is variable and that the higher performing agencies have valuable lessons for those that perform at a less optimal level.

14

Measurement Ties It All Together

- Can't manage what you don't measure
- NZ public sector now better measured
- Can improve reporting on what we measure

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A common theme in all of the work being done to manage the Public Sector in New Zealand is that in order to effectively manage performance, we have to know how the public sector has performed in the past and compare it to how it is performing now.

It's the old adage that: "you can't manage what you don't measure."

Measurement of the public service's performance is rapidly improving in New Zealand, but there are still significant issues that need to be addressed. We are also weaker than we should be on how we report our performance, particularly in how we report on what really matters – how we deliver outcomes for taxpayers.

The Challenges We Face

- Be clear on how we achieve outcomes but don't hide behind them
- Be clear about how much each output costs
- Use measurement for performance improvement, not just accountability
- Price, quality, standard

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A challenge for central agencies is that we need to measure and report on public sector performance in rigorous and transparent ways so that taxpayers understand what they are getting from the government and what it costs.

Historically, New Zealand's public sector agencies haven't been very clear with Ministers and the public about what they're getting and what it costs. Public sector agencies need to be able to tell whether we are making an impact on the objectives the government wants, and whether we are doing our work efficiently.

The Treasury has a leadership role here, along with the Office of the Auditor General, in providing better guidance to agencies about how to create and provide useful performance information. Better information allows us to deliver the services that New Zealanders need. It also helps guide and manage public sector leaders to take these steps.

We really need to understand how to get the most out of our resources. Performance monitoring is important, both at the central agencies -- for making big decisions -- and further out at the coal-face, for managers in individual agencies. We currently don't have enough good performance information.

It seems possible - maybe even likely - that one of the things that holds us back from maximising our performance is a too-narrow concept of how we think about using performance information.

Historically, we've seen the central purpose of public sector management as one of accountability for taxpayers' money spent, rather than improving performance. In practice, this has meant lots of reporting – to the point that we are almost drowning in data.

Scrutiny plays an important role, but we need to make sure we also have the right information to drive change.

The New Zealand Treasury's goal is a leadership model where everything we do is driven by, and can be directly traced back to, the outcomes that the Government wants the public sector to achieve; and where we think across the public sector and work collectively on the difficult issues that we need to tackle.

Performance reporting would not reduce the accountability of individual Chief Executives or Ministers for performance, but it would require the New Zealand public sector to rethink the way it manages its own performance.

The Minister of Finance summed up the challenges we face in a speech in September 2009, when he said: "Getting a better understanding of what we currently do, and what it costs, would be a good place to start. All public service agencies need to know the price, quantity and standard of their services and activities. Good decisions are informed decisions."

In a follow-up speech in August 2010, he said: "It's not an option for the public sector to wait out these challenges. Hope is not a strategy. And it won't work because the New Zealand public wants to see evidence that the public sector is living within its means."

And that is ultimately the challenge that New Zealand's public sector faces: using the right performance information to drive change and demonstrating to taxpayers that we can and do live within our means.

Thank you.

ENDS