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The State Ten Years On from the Reforms

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Te Komihana O Ngā Tari Kāwanatanga

This paper was prepared by Colin James as a guest contribution to the State Services Commission's 'Occasional Papers' series.

In this essay the author provides an informed and shrewd perspective on changes in the State sector during the past 10 years, and works to his brief by provoking the reader with his insights and challenges.

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In the 'golden age' of the 1960s the State took around a quarter of gross domestic product in taxes and provided a generous social wage by way of education, health, housing, welfare services, and income assistance. There were disagreements about whether the social wage was high enough – New Zealand had lost its leadership to northern European welfare states – but few disagreed that, if the political will was there the means could be found.

The 1972 *Royal Commission on Social Security* crystallised that sentiment in the proposition that the welfare state should 'ensure … that everyone is able to enjoy a standard of living much like that of the rest of the community and thus is able to feel a sense of participation and belonging to the community'. This was in what historian David Thomson has called the 'whiggish' spirit of the times, – the heroic assumption that continuous 'progress' could be made towards a perfectible society. This belief was underpinned by a continuously expanding economy.

Heroic whiggishness has not disappeared. It persists in the notion, particularly among well-paid academics in the social sciences, that State services, and especially the social services, can and should be demand-driven, – that social justice requires that. That is, despite the fact that the tax take is now more than a third of GDP, and demand has outstripped supply.

As incomes and wealth have risen, people have tended to spend more on services. Among those services are education and health. These services are supplied in New Zealand mainly by the State. While individuals could direct their demand for those services to the private sector, and some do, most see their (and/or others') taxes as having pre-paid their use of State-provided services. But meeting an ever rising demand requires ever higher taxes. And, since, on average, real incomes for ordinary folk have risen only slowly in the past quarter-century, and higher taxes cut into disposable income, there has run counter to the demand for government services a demand for lower, or at least not higher, taxes. This is not universal – several polls have reported majorities prepared to pay higher taxes for more secure health services (though not for higher payments to beneficiaries). But higher taxes would in any case not quench demand if demand goes on rising with wealth.

Matching demand with taxes or vice-versa is a matter for politics. Over the past 15 years politicians have used three main approaches. They have returned the economy to the markets and abandoned the allocative role assigned to governments by keynesian demand management theories, and social democratic ideologies. They have introduced co-payment (user-charges) and devolved some activities to non-State agencies. They have targeted income assistance more tightly to need, to save money and encourage selfhelp. Advocates for the demand-driven welfare state have complained that this amounts to ‘rolling back’ the State, to take Professor Jane Kelsey's phrase.

Yet at the same time the State has also been advancing. It is doing this for two reasons.

One is technological: more and new things can be done so more should be done, even though much of it is very expensive. This is particularly noticeable in health services. The humanitarian idea that people should not suffer or die when help is technically feasible, has demanded miracles of the health system.

The second is in a sense technocratic, though driven again by notions that the State can improve society. So we have a ‘strengthening families’ programme built on the belief that if only the State tries hard enough it can ‘break the cycle of disadvantage’. We have a hugely expanded tertiary education sector which aims to upskill our people to succeed, or at least survive, in the unforgiving international marketplace where skill is increasingly disproportionately rewarded.

This has taken place against a background of a diminishing capacity of the national State to control our economic destiny and simultaneously, a greater particularisation by individuals and households of their expectations of all services, including those of the State.

Markets, which once were local, then became national, have now become international. The government signs around 30 treaties a year; there are thousands of international agencies. These impose constraints: the treaties on freedom of legislative, and some administrative action; and the international marketplace on taxing power and scope for economic regulation. In a world where borders are less definable and defendable than they were, how can governments truly control what happens within their topographical domain? Ask the Internal Affairs Department, struggling with internet porn; in a decade's time, ask the Inland Revenue Department, struggling to collect GST on purchases initiated in New Zealand but actioned in nebulous cyberspace.

At the same time consumers have become increasingly picky about quality and expect their goods and services customised. This is true of the State sector as much as the private sector. They will no longer settle for the standardised output of the 1960s-style factory State. Mass-produced education won't do, for example, not if you want to get on. This particularisation of demand has posed at least as big a challenge to the State as the matching of resources and demand. How does the State, almost by definition a monolith, develop the flexibility to respond to individuals’ varying needs and wishes?

The first response in the 1980s to these twin demands for more and greater customisation amid the challenges of internationalisation and constraints on resources was to strip out costs. What could be described as ‘business’ was removed from ‘government’ and made ‘business’. Telecommunications were a public service in 1986; now they are a private good. Most of these businesses are now in the private sector. State servants were restrained from rent-seeking by separating the provision of services (a ‘business’ or quasi-business) from funding of them, and putting the two on either side of a contract specifying what the taxpayers' money was buying. In some departments policy advice and regulatory activity were also separated out. Cash ceilings on departmental budgets squeezed more work out of State servants for the same money and aimed for more innovative management. Financial reform, which included a shift from cash to accrual accounting, gave departments autonomy over inputs, but required them in return to specify in auditable form what outputs they produced for their slice of taxpayer's funds. Private sector management theory was imported to sharpen management, which became less rules-based and more objective-oriented. From the top down State servants were enjoined to focus on the 'customer', 'consumer', 'patient' and end-user. After all, who is this 'business' for?

This first round of reforms in 1988 and 1989 profoundly changed the State sector. It was slimmed down to something approaching a 'core' of national, administrative and social services activities. Permanent secretaries – who were 'permanent' until they reached mandatory retirement age, and 'secretaries' in the sense of (pretending they were) being ministers' factotums – became 'chief executives' who were expected to emulate their private sector counterparts, contracted (in a sense as equals) to ministers with specific performance contracts.

But once the costs were stripped out – or at least carved back to a point of diminishing gains – what then? The 'New Zealand model' turned out to be a primer, not a textbook. It has become dismayingly clear that organisational improvement is a continuous process, not a once-and-for-all repair, like the reform of 1912.

That requires the State sector not just to do better what is already being done, but also to develop a capacity to anticipate, ensure, and facilitate continual adjustment, while retaining a long-term strategic focus. And all this must be done in an environment where there is continual downward pressure on taxes, and continually rising demand.

For the moment the preference has been for intermediate 'solutions'.

One intermediate 'solution' that is supported by the general population in surveys is to tighten income assistance to the unemployed and domestic purposes beneficiaries, and other 'undeserving', or only partly deserving or unconvincingly deserving poor. This fits survey findings that taxpayers want both lower taxes and more services – which may seem paradoxical until it is realised that people habitually tell surveyors they support more government spending on education, health and superannuation, from which they or their immediate families benefit directly, but are parsimonious in their support for benefits for others. So the government has continued to target to need, most spectacularly in the 'mother of all budgets' in 1991, and recently in re-indexing State pensions to prices instead of wages.

But welfare rolls all kept rising. We now have 520,000 people, not counting superannuitants, on State income assistance. 'Need', it seems, is elastic.

This has brought the State face to face with another conundrum: on the one hand rising discomfort (mainly among officials but also among the public) with increasing 'dependency'; on the other hand a residual egalitarian sentiment and dislike of crime and beggars. There are social cohesion and political costs from being too stringent.

So the State has embarked on another intermediate 'solution': active (but still restrained) encouragement and assistance to beneficiaries to get work skills, get the work habit and get work. To do this properly will require expensive individual one-to-one assistance, which brings the State back to the question of resources. And, in any case there is an anterior need. Many people are effectively lost to the workforce by the time they reach their teens. Bad early childhood experience is a major constraint on eventual ability to foot it in the international marketplace. And that can be redressed only generation by generation, and only with intensive intervention by highly skilled counsellors. So, the State has stepped into family rehabilitation, parental education, and rescue of ‘at-risk’ children.

And here we have back, in another guise, the expanding state of the heroic 1960s, the State as builder of the perfectible society.

In the unheroic (anti-heroic?) 1990s this poses some big questions.

First, resources. Why not just raise taxes? If people want more of a State-provided service, logically they will, if confronted with the bill, be open to persuasion to pay for it. ‘Third way’ economist and former Clinton cabinet minister, Robert Reich, argued that with force when he was here earlier in the year.

At some point in the next dozen years or so there is likely to be a government which tries this ‘solution’. The current received wisdom says a political party cannot raise taxes and win elections. But this wisdom has been dented by John Howard's GST win in Australia in October. The electorate may well be willing at some point to accept higher taxes.

But this assumes there is some equilibrium point at which taxes and demand for government services will match up. Certainly, in voters' minds, that seems to be so: surveys here and overseas record preferences both for higher spending on education and health, and lower taxes. This is not wilful blindness on voters' part. The higher spending they want is on services they expect for themselves or their immediate families: education, health services, superannuation – what might be called the ‘me-too’ services. The lower taxes can be accommodated, voters in effect tell surveyors, by restricting income assistance to the ‘deserving’ poor and cutting down assistance to the ‘undeserving’ poor.

The National government has in fact been striving to do just that. Its misfortune is that the ratio of ‘undeserving’ to ‘deserving’ poor does not yield enough to meet demand for the ‘me-too’ services. So it has dolloped out some money, pushed for managerial efficiencies, and kept a lid on State sector administrative budgets. There have been some impressive achievements – a 20 percent increase in hospital operations per head of population between 1988/89 and 1997/98, for example.

But there are limits to this intermediate ‘solution’. Already, the government has gravlaxed administrative budgets to the point where policy analysis is being impaired for lack of competitive salaries and lack of numbers. Evaluation of programmes is disgracefully slim.

And, in any, case a fiscal crunch is looming. Demographic projections suggest that from 2015 health and superannuation spending rise sharply. Even maintaining ‘core’ government spending only at the present level relative to population, the tax take would have to rise from 2020. Conversely, if the tax take is held down, the ‘core’ would disappear by 2030; thus, it is argued, continuing to reduce expenditure in core government as a means to fund increasing social spending, as has been the case through the 1990s, is not sustainable. The alternative is to cut back on health and superannuation.

Of course, it is possible that fiscal crunch may be averted. Technology might at some point make health care cheaper faster than it is making it dearer, thus bringing health budgets down rather than pushing them up, and might produce other savings. And demographics might take a dramatically different turn. Projections 50 years ago were for a much smaller and more agricultural country than we have. We might turn out to have a much higher ratio of workforce participants to superannuitants in 50 years than today's projection. Moreover, if ethnic Chinese come to be 10 percent of the population, the savings and taxation cultures might change significantly.

But that is in a speculative future. The fiscal crunch looming on present trend evidence poses some difficult choices down the track.

Start with an easy one: is it better to own a postal service than give kids a chance? For the moment that is a non-question because New Zealand Post makes a profit. But what happens if New Zealand Post needs capital to stay up with the play in its now highly competitive market? The State is the only shareholder so the capital must come from the State. Would it be better to sell New Zealand Post to keep government funds for the kids?

Now try a harder question: Is it better to provide on-demand 'elective' surgery for the middle-aged and old, than give kids a chance? Adults could conceivably build the possibility of at least some elective surgery into their savings plans, if they are given enough notice – say, everybody born after 1975 or 1980. After all, all except the hardest-up pay for their GP services now. Kids can't pay, and they and we pay later if we neglect their needs. Can we afford – not only in equity, nor even only socially, but economically as well, – not to put the effort into giving kids the chance to become self-sustaining in the international economy? And, especially, can the social and economic fabric stand the strain if so many of those falling behind are Maori and Pacific Islanders, rising as proportions of the total population?

Now contemplate the alternative to raising taxes, one Bill English has canvassed for some years now. That is, that there will be a point where, if voters are confronted with the bill in the form of higher taxes, rising numbers will conclude they would rather pay for those services through other channels. This implies that some 'public' goods are in fact 'private' goods. These arguments, set to rest in the 1930s and 1940s as the welfare State was put in place, are back with us as a many times richer society tests to destruction the concept of 'free' public goods.

English's point is not just an ideological preference for private purchase over universal State provision. It is also his assessment of what is likely to happen.

If he is right – and the demographic and fiscal projections suggest he may well be – the State will face hard choices, for which inventive solutions will be needed.

Neither hard choices nor inventive solutions are likely to come from the politicians. They are short-termist, seldom skilled, policy analysts and foremost concerned with re-election. In any case their role is to translate the public will into requests for State action. That is, they state the 'must do'.

It falls to State servants to delineate the ‘can do’. They, after all, are a constant where politicians are transitory. In theory they have the analytical skills and strategic perspective to establish what can be done; of what the voters want and how to do it.

For example, can the State actually ‘strengthen families’? Can the State actually improve the health status of New Zealanders generally? Maybe? We are asked to suspend judgment for 20 years while the State proves the point. But, might not the limit of the State's reach be facilitating access to some tools for families, and individuals to strengthen themselves and get themselves healthier?

It also falls to State servants to develop rational prioritisation of scarce resources. Ministers’ criteria of success centre round being seen to have done something, successful or not, which can be put before the electorate after three years. If more appropriate criteria, such as ‘added value’, or ‘doing what the State can do better than anyone else’, are to be applied as a way of getting the best return from taxes in the long term, they will have to be developed by State servants.

To do this sort of strategic analysis is not to ‘yes, minister’ ministers, chief executives lording to themselves a presumed superior role, – as one former chief executive says the permanent secretaries used to do over their whiskies late at night. Nor is it to ‘no, minister’ ministers, blocking or delaying action, as a current chief executive reckons was done to the incoming Labour government in 1984. It is to bring as much rationality as possible into public policy.

Have the 1988 reforms equipped the State service for this role? Only partly.

Chief executives still sit in ‘silos’, portfolios delineated in some cases decades ago. They fight ‘turf’ battles. They do too little evaluation of programmes, and, that often perfunctorily. They take too few risks (understandably, in the light of the political realities of working to a minister, but that is not the point). They stimulate too little creative thinking and action at the front line. Too many resemble the second-class, private sector chief executive who pursues higher profits through cost-cutting, and too few resemble the first-class private sector chief executive who thinks laterally into new forms of revenue.

Of course, all that is an overstatement. There are some impressively innovative chief executives who combine strategy with judicious risk-taking, and there are few who have not tuned up their departments. The 1988 reforms did refocus energies and open up room for creative policy development and better directed service delivery. The State sector is more useful, relevant and productive.

Moreover, the reforms have proved capable of considerable useful refinement. The development of SRAs (strategic result areas) and KRAs (key result areas) was a first bailey bridge over the void between outputs and outcomes. A new bridge is now under construction with the move to ministerial ‘teams’ and super-portfolios, putting major areas of coordinated activity under the oversight of a single minister.

But the 1988 reforms were one step. There is not a new static status quo. There is a need both for continuous improvement (as distinct from cost-stripping) and for an ethos, processes and mechanisms which facilitate, encourage and ensure continuous improvement. ‘Permanent’ is out; so is the passive, rule-bound ‘secretary’. ‘Chief’ and ‘executive’ mean what they say – in the private sector, responsibility for a strong share price; in the State sector, responsibility for measurable progress towards relevant outcomes. Private sector boards, especially those overloaded with limited-horizon lawyers and accountants, can be as risk-averse as ministers. The best private sector chief executives talk their boards through innovation. The best ministers take risks.

Four areas for major change stand out. They are much less to do with systemic and organisational change, which was the essence of the 1988 reforms – though there are serious questions to be asked about the plethora of small departments and Crown entities. The most relevant changes the State sector now needs are in attitude, working methods, and risk.

Start with better cross-portfolio coordination. Several attempts have been made at this, with mixed and incomplete results. The teams and super-portfolios announced in August look a useful next step in focusing ministers and chief executives on pan-government priorities, and in eliminating duplication of effort, which holds out the prospect of lowering overall costs. Also, they should obviate, at least for a time, the need for more structural reform, an orgy of which the 1988 reforms unleashed and which have often damaged morale, institutional memory and performance.

Look at cross-portfolio coordination from the other end of the telescope. It is about getting specific things done to meet specified needs, many of which don't fit inside the policy and service delivery boundaries of one portfolio. Getting things done requires appropriate people assigned to do them, regardless of ‘silo’. Electronic networking and imaginative management should be able to create virtual mini-departments across the State sector, assembled and reconstituted as needed and disbanded when the project is completed.

A minister of strengthening families does not so much need a Social Welfare Department as selections of analysts and implementers from the courts and police across to the education and health portfolios, besides ‘welfare’ specialists. A minister of regulation needs not only a Commerce Ministry but analysts from education, health, justice and the Treasury at least. The Foresight Project, a brave attempt to get businesses to think themselves laterally into knowledge-based business spinoffs of their current activities, will fail if it is thought of only as a science venture.

The second major area for development is strategic management. This is not to develop a particular strategy and stick to it – why after 15 years of Rogernomics is the economy still not matching Australia's? Nor is it simply to hang a policy bid, or a budget item, on an SRA – SRAs are in any case too vague to be of much strategic use. It is to develop the capability to provide long-horizoned advice regardless of the politicians’ short-term alarums and excursions, and similarly to maintain a sense of longterm policy purpose; to uncover and clarify long-term objectives for ministers, to develop the government's policy ambitions into a coherent strategy. That requires considerable refinement and development of the SRAs and KRAs or the development of a new way of specifying outcomes. This may be under way in one respect: announcing her ministerial teams on 30 August, the Prime Minister said she expected them to develop new SRAs.

Strategic management also involves aligning all workers in a department with the strategy so they know how what they do relates to outcomes the government is seeking to bring about, and then can be more constructively creative in their work. An important element in this is evaluation, assessment and feedback from frontline staff and managers, and constant reshaping of programmes in the light of experience – what some call ‘emergent strategy’.

The pursuit of long-term objectives might also reduce costs. If ‘strengthening families’ is achievable and does work, it may well cut outlays at the very time the demographic crunch arrives.

Closely related to strategic management is risk management. This is not avoidance of risk. Nor is it the management of simple risks, such as whether to buy or lease. It is to know what to risk, when, and how. Without risk there is safety, but there is also stagnation, ossification, a poor return on taxes.

The enticing example is the private sector market. Risk there translates into either reward or failure. It is this ‘creative destruction’, the elimination of failures and the reward of successes, which gives markets their wealth-generating vitality and sifts out what works best.

The State is not and cannot be a market – its major role is to provide what the market cannot be relied on for. Moreover, politicians hate risk because things that go wrong can amount to embarrassment, demotion or lost votes. That is an incentive to chief executives to steer clear of risk lest they preside over things going wrong. And when things do go wrong there is a tendency to overcompensate, to devise swaddling rules to preclude a repeat.

So programmes don’t usually get off the ground unless there is a high level of confidence they will succeed (or at least not fail, which in political terms is probably the same thing). Thus, ‘pilots’ in the State sector are seldom true pilots, which are subject to disbandment if, on assessment, they are found not to be achieving their objective. More usually they are fore-runners of full-blown programmes and, thus, hard to stop, even if they turn out to be suboptimal. Evaluation is limited (in case a chief executive is seen to have got something wrong, heaven forbid?). Processes in the State sector for cutting losses or cutting out sub-optimal programmes, which markets force on firms, are not well developed.

Yet, if innovative and inventive ways are to be found to deliver better government services, better targeted and more productively, they are not likely all, or even mostly, to be discovered at the centre. Cutting-edge private sector theory suggests, that within organisations, innovation depends on constant regeneration. Translated to the State sector that means more empowerment of frontline staff, far better information feedback, and constant assessment and evaluation.

In short, and this is the fourth major area of change in prospect, there will be more decentralisation and devolution – not just in delivery of services within strictly defined parameters, which is now becoming more common, particularly in health, but also in decision-making power. Decentralisation is scary enough for risk-averse chief executives, giving more discretion to frontline staff in order to get better performance, though the evidence from the private sector of improved work practices and output is sometimes astounding (Comalco is a good example). Devolution is even scarier because it involves outsiders who have different ways of doing things. Devolution is a test of skill and nerve.

But if ‘solutions’ are to be found to the truly knotty social questions the expansionary State is now trying to address, they are unlikely to be found only, if at all, at the centre.

Partly, this is an issue of which level of government is best suited to meet different demands. Overseas surveys say people have more confidence and trust in lower-level than in national governments, and anecdotal evidence suggests New Zealanders' relationship with local government is more direct than with the national government. Yet the proportion of public services delivered by local government is far below that in comparable small countries in Europe.

Partly, the issue is that one size does not fit all, and the best people to find out what size does fit are more likely to be found cheek by jowl with the ‘customers’ than in Wellington tower blocks. State servants' role then is to find out which solutions fit, and facilitate them.

That means accepting failures, maybe lots of them. But this runs counter to the instincts and training of State servants. In fact, the 1988 reforms, with their accent on contract, sent the State in the other direction, tying outside agencies down so tightly in contracts that they are almost back to pre-1988 rules-based administration, far removed from imaginative management. The Plunket Society, for example, used to be funded to produce generalised outcomes; now it is contracted for highly specified outputs, satisfying central government monitors but stultifying initiative and perhaps delivering less for the money. Some lower-level managers within departments are complaining that their contracts have become rather like the old rules the 1988 reforms were supposed to have swept away.

The answer is more trust and more ‘relationship contracting’ – looser arrangements which rely on strong understandings between purchaser and provider. But this is fraught with auditing and accountability difficulties and issues of competence, focus and honesty. Remember the scandals around the Maccess schemes of the late 1980s?

Despite these risks, decentralisation and devolution may well be the biggest issues for the State sector over the next 10 years. The 1988 reforms improved systems. The need now is to inject more creativity.

For that, high-quality State servants are needed. That means high salaries, with tough performance measures attached to them, and enough people to do the job. The best systems won't work if the people aren't up to the task. The problem here is bone-headed ministers who think State servants are paid too much, and persist in seeing State outputs as costs instead of investments, oblivious that the price of failure may be a continuing decline of popular trust in the institutions of national government.