Chapter 4

Creating Clarity of Purpose

The Big Bang Down Under

In late 1987 the government of New Zealand began auctioning off its publicly owned businesses. In just two and a half years it sold banking, finance, insurance, oil, film, printing, hotel, steel, shipping, and telecommunications operations, as well as Air New Zealand. The sales generated more than $8.2 billion in New Zealand dollars (about $5 billion in U.S. dollars). The government also put its coal and forestry businesses on the block and prepared its railroad system for privatization.

This was not a case of conservative politicians ending public ownership, as in the United Kingdom. In New Zealand, the sell-off was initiated by the Left. The Labor Party, long an exuberant champion of public ownership and aggressive government intervention in the economy, was beginning its fourth year in power. From the beginning, it had been forced to abandon its long-held philosophy and develop a new one on the fly.

When it won the 1984 elections, the Labor Party had been out of power for all but six of the previous 34 years. Then fortune smiled, quite unexpectedly. Prime Minister Robert Muldoon of the National Party called a surprise election for Parliament, hoping to catch his Labor opponents napping. He did—but voters turned overwhelmingly to Labor anyway. They had good cause: the economy was in rough shape.

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In 1950, New Zealanders enjoyed the third-highest per capita income on the globe. Since then, this island nation of 3.4 million had experienced one of the slowest annual rates of productivity growth in the industrialized world. Real wages had stagnated since 1960. In 1973, a combination of the international oil shock and the United Kingdom's entry into the European Economic Community—which created serious competition in New Zealand's major export market—brought economic growth to a temporary halt. Unemployment, virtually zero in the 1960s and early 1970s, climbed to 5.4 percent by 1983, a major cause for alarm among people long accustomed to full employment. By 1984, New Zealand was twenty-first in per capita income.

Both major parties in New Zealand had long been committed to active intervention in the nation's economic affairs. The government owned a huge portion of the economy. Extensive public subsidies, high tariffs, and import controls protected New Zealand businesses. Markets were heavily regulated. In addition, New Zealand had developed an extensive social safety net. Public pensions dated from 1898; health care, housing, and college education were heavily subsidized.

As the economy worsened, National Party leaders had increased spending rapidly, particularly for social services and large economic development projects. They had tried to restrain other spending with a series of across-the-board cuts, but had failed. By 1984, the national budget exceeded 40 percent of gross domestic product (GDP) and the government was borrowing heavily. This helped drive inflation—which averaged 12 percent between 1970 and 1984—to 15 percent by 1982. Interest payments on the debt ballooned to nearly 20 percent of government spending. In desperation, National Party leaders played their last card: in 1982 they froze wages, prices, and interest rates.

Labor's new ministers took office with no plan for changing these trends and little time to develop one. Within days of the election, the country almost defaulted on its foreign debts. The Reserve Bank had to suspend foreign-exchange transactions, while the Labor government devalued the currency by 20 percent.

Meanwhile, senior officials in the powerful Treasury Department, which managed fiscal policy (budgets and financial management) as well as economic and regulatory policy, were feverishly updating a set of recommendations the Muldoon government had ignored. Within weeks of the election, they handed their report, called "Economic Management," to the incoming ministers. It advocated far-reaching economic deregulation to end government's direct control over large parts of the economy. And it proposed to

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streamline, break up, and radically reform the nation's public bureaucracies.

The Treasury's advice struck at the heart of the Labor Party's philosophy. For most of the twentieth century, Labor had championed the expansion of the national government. Now it was being told that the only way out was to dismantle the system it had helped build.

Roger Douglas, Labor's new finance minister, pushed hard for the new direction. A combative third-generation Labor politician, Douglas was first elected to Parliament in 1970. He had routinely supported both government intervention in the economy and the expansion of the state. But by 1984, he says, he "had decided that governments didn't have to run so many things. Their role was to design an environment that positively encouraged the people they represented to go out and run things."

Necessity became the mother of reinvention: Douglas and his colleagues embraced the Treasury recommendations. It was a pragmatic decision, says Graham Scott, then a senior Treasury economist who had helped prepare the report. "[Labor] found themselves in the middle of a crisis. Everything else had been tried. There was only one way left to go." Still, Scott recalls, the decision was a surprise: "Suddenly, I was working for people who were saying yes instead of no."

Labor initiated shock therapy. They focused first on the domestic economy, ending decades of public subsidies and regulations and revamping social programs. They lowered tariffs that protected industries, removed wage and price controls, lowered the tax rate, and broadened the tax base. By 1988, they had cut the top individual tax rate (which kicked in at only 2.5 times the average income) from 66 to 33 percent and the corporate rate from 45 to 33 percent, while adding a 12.5 percent tax on consumption. In addition, they:

- deregulated several major industries, including finance, transportation, and energy;
- ended most public subsidies to agriculture and industry;
- eliminated controls on most foreign investment;
- ended all subsidies written into the tax code;
- instituted a means test for government pensions; and
- provided low-income people with funds to spend on either private or public housing, rather than placing them in state-owned housing.

Then they trained their sights on the bureaucracy.

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Big Bang Day

By 1984, New Zealand's government owned and operated 12.5 percent of the nation's economy, including some of the nation's largest banks, its largest automobile insurer, the largest farm-mortgage lender, the entire telecommunications industry, all wholesale electricity distribution, all the ports, the rail system, the only national airline, a national shipping line, more than half the commercial forest land, the only two television channels, most of the coal industry, and a major hotel chain.

Some of these businesses "operated under the direct control of ministers," explains Douglas:

> *If those enterprises failed to deliver what the public wanted, then anyone could write to the minister, seeking political assistance— to get a telephone, for example. What could be more open or more democratic? People wrote to MPs in the thousands for help to get telephones. They also believed that the system gave them better control over the prices charged by State-owned enterprises. Interest groups offended by suggested price increases could lobby the minister successfully to prevent or defer the increase...*
>
> *Every year, Cabinet sat down solemnly and decided how much money to vote to government businesses. They approved or vetoed all capital expenditure. Their ability to match prices to their own political priorities was very convenient. If unemployment became a problem in a particular part of the country, ministers could absorb those people into the State workforce.*

These publicly owned businesses performed a conflicting mix of business, regulatory, and social roles. For example, the state coal agency owned most of the nation's coal mines. But it also regulated coal mining, and in that role it was responsible for licensing its private competitors.

Overall, government-run businesses suffered from poor manage-ment, low productivity, and poor investment decisions. The Post Office, which handled telecommunications, had a two-year supply of dial telephones that nobody wanted. The average wait to have a telephone installed was six to eight weeks. The coal business had lost money for 20 of the past 22 years. The organization managing government property was paying bills on facilities it could not even identify. The bureaucracy's attitude, says then-minister Richard Prebble, was, "There's no mistake that money can't fix."

In the previous two decades, the government had invested $5 billion in

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these business activities, but the net return on that investment had been zero.

Douglas pressed his colleagues to turn government agencies that produced goods and services with commercial value into public corporations, known in New Zealand as state-owned enterprises (SOEs). This immediately triggered hot disputes within Labor's ranks, as well as resistance from public sector unions and the bureaucracy's managers. After Douglas won Cabinet approval of a massive corporatization initiative, department managers stonewalled the effort. "Every conceivable attempt was made to delay, sidetrack, relitigate and reinterpret the thrust of the principles, and turn the government's nose in some other direction," Douglas complained.

Douglas called in Graham Scott, who was by now Treasury secretary, and a few other allies. "He said, 'Look, I want this problem fixed and fixed quickly,'" says Scott. "He set up meetings with a handful of us that he thought agreed with the policy, and asked, 'How are we going to get this fixed?'"

After many late-night sessions, the breakthrough came in a hallway conversation. Scott, Douglas, and Geoffrey Palmer, the deputy prime minister, had left a meeting to get some coffee. "We had been told that it would take 40 acts of Parliament just to create a forestry corporation," Scott remembers. "We said that would never work; we have to find a way of going over the top." Palmer suggested a legislative shortcut. Instead of changing the innumerable laws, the administration would get blanket authority from Parliament to corporatize government entities; in return, it would notify Parliament before any specific corporatization was undertaken.

"It was decided that night, and it was government policy in a week," says Scott. Parliament adopted the legislation in 1986 and scheduled the first wave of corporatization for April 1, 1987.

On "Big Bang Day," nine state-owned enterprises came into existence: coal, electricity, property management, land, forestry, the Post Office, the Postal Bank, telecommunications, and air traffic control. The change affected some 60,000 government employees—more than half the departments' and agencies' staff. For the first time, these organizations would face market pressures. With the exceptions of the Post Office, which maintained its monopoly on first-class mail, and the

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air traffic controllers, they lost their statutory monopolies. Although the government still owned their assets, SOEs had to pay taxes and could no longer draw free capital from the government. They reported to independent boards of directors instead of elected officials. The boards negotiated the corporate direction with ministers. They selected and contracted with chief executives, who were unshackled from government employment, budgeting, and procurement systems.

The changes were the equivalent of a hostile takeover in the business world, in which new management is installed to pursue goals entirely different from the previous management's. Almost immediately, the SOEs laid off huge numbers of civil servants in order to boost their productivity and competitiveness. The forest SOE cut salaried staff by two thirds; the railroad SOE cut employment from 21,000 to 11,000 in four years; the telecommunications enterprise dropped from 25,000 to 14,000. "The Post Office, the electricity, coal and forestry industries had been billing both taxpayers and consumers for thousands of workers who had never been needed at all," says Douglas. Within five years, the SOEs would cut employment by more than 50 percent.

Over those same five years, the SOEs registered astonishing turnarounds. Telecommunications increased its productivity by 85 percent and cut prices by 20 percent. The coal SOE maintained previous production levels with half the workforce, while cutting prices by 20 percent. The rail SOE cut freight prices in half, while turning a $77 million loss into a $41 million profit. The Forest Corporation turned a $70 million loss into a $53 million profit in just one year. The postal system, which had lost more than $38 million in 1986-1987 and was projected to lose more than $50 million the next year, instead made a large profit—without raising the price of basic mail. By 1995, it had cut the real cost of a standard letter by a third. (All figures are in New Zealand dollars, which have been worth 50-70 U.S. cents over the past decade.)

As a whole, the SOEs increased their revenues by 15 percent and quadrupled their profits during their first five years. By 1992, they were paying roughly $1 billion in dividends and taxes. The gains were far beyond anyone's expectations. "We couldn't believe it," says Scott, an architect of the policy. "We were all surprised."

Privatization and Much More

The economic effects of the Big Bang were spectacular—and they triggered even more fundamental shocks. After Labor increased its majority in the 1987 election, it began selling off SOEs and other public businesses.

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One reason was to reduce the deficit. Another was that the SOEs had become a headache, because ministers now had public accountability for them but had given up control over them. For instance, the government chose not to set SOE prices, but when an SOE raised its rates, the ministers still got the flak. So ministers began asking: Why bother owning them? If we can't control them, why keep them in the public sector?

The third and most important reason was simple economics. Labor's experience with SOEs—and Margaret Thatcher's successful asset sales in the U.K.—convinced them that still greater efficiencies could be achieved by ending public ownership.

"We were getting increased efficiencies because we were exposing state monopolies to competition or the threat of it," says Douglas. "The outcome demonstrated that competition is far more effective than either ownership or regulation in extracting efficiency from business operations on behalf of the owner, and performance from it on behalf of consumers." Echoing an argument Treasury officials had raised since 1984, Douglas and his allies concluded that government was not a good owner of businesses; that keeping businesses in government's hands might generate pressure for additional public spending; and that ministers should spend their time on economic and social policies, not commercial activities.

The privatization process was not always smooth. Several times the sales process was reopened after a winner had been selected, because of political infighting within the cabinet. Another sale ended up in receivership and a legal squabble. And a public controversy erupted when the new private owners of the Rural Bank made a large profit in their first year.

These problems slowed but did not stop privatization. By 1991, the government had sold all or part of Air New Zealand, the Petroleum Corporation, the Bank of New Zealand, the Rural Bank, the Post Office Bank, the Shipping Corporation, Government Life, the Forestry Corporation, the Tourist Hotel Corporation, the Telecom Corporation, and others. By 1995, it had sold more than 20 state organizations or assets, which represented more than two thirds of its commercial assets, by dollar value.

As they sold off SOEs, Labor ministers also thought about how to apply the lessons of their startling success to what they called the "core public sector." They assumed that waste and inefficiency were also rampant in defense, policing, criminal justice, health, education, environmental, and welfare agencies, where they could not create market discipline through privatization or corporatization.

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As early as 1984, Scott and other Treasury officials had argued for fundamental changes in the bureaucracy. In their view, it was a bloated, unmanageable, inefficient drag on the nation's economy. Its conglomerate departments combined a hodgepodge of different functions: policy making, regulation, service delivery, and compliance. They lacked clearly defined objectives and had no management plans. They generated no information about how well they were performing. Managers had little real control over personnel or budgets, because a central civil service system set salaries, classification levels, and working conditions, while the Treasury controlled budgets and finance. Unionized public employees enjoyed automatic annual salary increases. The central administrative systems gave managers no incentives to perform well or to improve performance. In this system, it was extremely difficult to save money.

As Labor officials watched the success of the SOEs, says Scott, they began "to search for a framework that would bring analogous incentives for efficiency to the activities of other government entities and departments." In late 1987 they backed a Treasury plan to create explicit customer-supplier contracts between elected ministers and the departments. Ministers would determine policy goals and then purchase whatever outputs they thought would help achieve those goals, from departments or other providers. Departments would be accountable for delivering the specified outputs. In short, ministers would be responsible for steering—setting direction—and managers would be responsible for rowing—getting to where ministers wanted to go.

In order to make the departments truly accountable, Treasury added, managers should be given the freedom to decide how best to produce the outputs ministers wanted. That meant ending civil service, procurement, and most budgeting controls. In addition, managers and agencies should have economic incentives for improving their performance.

Labor's leaders were already deeply suspicious of the bureaucracy. They believed that in the mid-1970s, when Labor had a short term in office, senior managers had sabotaged Labor policies. Their suspicions had grown into frustrations when they encountered bureaucratic resistance to the SOE policy and to ongoing efforts to cut government spending. To the ministers, the bureaucracy seemed unmanageable. "We found that as a new government we weren't actually in control of [the departments] in any real sense, and that came as somewhat of a surprise," explains Geoffrey Palmer, then deputy prime minister.

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Labor had not taken up Treasury's ideas before 1987 in part because some of the changes threatened the public employee unions, part of its political base. "The sensitive issue was always civil service reform," says Scott. In 1986 Labor adopted some modest internal deregulations. And in 1987 Labor's Stan Rodger, a minister and former public union chief, quietly tried to negotiate concessions from the unions. But the effort failed.

After the 1987 election. Labor decided to move anyway. "They'd obviously been waiting for the election to get out of the way," says Scott. "In two meetings of two hours each, all the key recommendations for civil service reform were decided. Then, there was a complicated dance between the government and the unions."

Without warning the unions, Rodger introduced comprehensive legislation—the State Sector Act of 1988—to change the basic industrial relations within government. Then he pushed it through Parliament at breakneck speed. "It's fair to say that I didn't consult on the bill," Rodger acknowledges. "The unions were very grumpy. They thought I had sandbagged them... They stripped me of my union medal."

Changes at the Core

By adopting the State Sector Act and its companion, the Public Finance Act of 1989, Labor hoped to bring private sector management practices into the public sector. As Rodger announced when he introduced the 1988 legislation, "What is good for private sector employers, unions and workers should also be good for employers, unions and workers in the state."

The main reforms changed the organizational structure of government and the basic rules for managing public agencies. As in the U.K.'s Next Steps agencies, government managers gained great autonomy in exchange for increased accountability for performance.

The new laws separated policy-making or steering functions from rowing functions. In order to clarify roles, the reinventors decided to break their large departments up into discrete functions—"hiving off," they called it. Generally, policy-advising, regulatory, service delivery, compliance, and funding functions were severed from one another. For example, the government broke the 4,000-employee Department of Transportation into six organizations. Five of them provided specific

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services such as maritime safety, accident investigations, and civil aviation. One, the Ministry of Transportation, provided policy advice to ministers. Once the corporate brain of an entire department, it shrank to fewer than 50 members. (Policy-advisory organizations are typically called ministries; others are normally called departments.)

Ministers would negotiate performance agreements with all departments and ministries, which would agree to produce a specified quantity and quality of outputs at a specified price. Ministers were free to purchase outputs from departments and ministries or from other providers. Typically, they would negotiate annual agreements with the organizations' chief executives. This gave them genuine control, for the first time, of what their departments and ministries produced.

The senior civil servant running each department or ministry would work on a fixed-term performance contract, rather than having permanent tenure. These chief executives—formerly known as "permanent heads"—now faced consequences for their performance. Job security and salaries would depend on their success in delivering the outputs they negotiated with ministers. Contracts could be for no more than five years. Chief executives would be recruited from the private sector, not just from the civil service, paid salaries more in line with those in the private sector, and given bonuses for high performance.

The new chief executives would have the freedom to manage their organizations' resources. The legislation transferred power over hiring, firing, salaries, and union negotiations from the 75-year-old civil service system to the chief executives. In effect, it eliminated almost all civil service rules. Public servants lost their guaranteed tenure; unions lost the ability to bargain uniformly for government employees in different departments. The State Services Commission's power over staffing numbers and the Treasury Department's control over day-to-day budgets shifted to the chief executives. Once budgets were set in negotiated agreements between ministers and chief executives, agency managers could spend the money as they saw fit. Power over purchasing decisions shifted from centralized procurement offices to the chief executives; they could buy what they wanted, when they wanted it, at whatever price they were willing to pay.

Departments and ministries were given incentives to manage their finances effectively. The government charged interest on all administrative funds and assets held by departments and ministries. (This is called the "capital charge.") Since managers had to pay for their money, they had an incentive to manage it carefully. In addition, the government required departments to use accrual accounting, which forced once-hidden forms of spend-

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ing such as future obligations or the declining value of assets into the open, by treating them as expenditures.

The role and function of central administrative agencies changed.
The Treasury no longer specified how each department should use its internal resources; its role was limited to setting broad budgets, providing ministers with economic policy advice, and managing government-wide finances. The State Services Commission, stripped of its control over personnel systems, focused on a few remaining functions: it appointed chief executives, reviewed their performance, and set some basic personnel and labor-negotiation policies.

Another Political Shock

In 1990, as Labor implemented its new management framework, it had to face the voters. After six wrenching years of internal policy disputes, the party was in disarray. Roger Douglas and Prime Minister David Lange had engaged in a prolonged, messy public wrangle over fiscal policy, which culminated in Douglas's resignation—followed six months later by Lange's. Douglas had wanted more aggressive tax and spending cuts, including a flat income tax; Lange announced that it was time to slow down the pace of change. At the same time, Labor's privatization program and reductions in government financial support for health care and university students cost it support among its traditional constituencies.

Labor had made little progress on deficit reduction, and as the election approached, it lost fiscal control. "They started spending money like an old-fashioned Labor government of the past," says Scott. For all these reasons—and because the economy was heading into recession—Labor lost the election.

The incoming National Party ministers had been on the sidelines for six years. Because they had wanted government management to improve, they had not been a great obstacle to Labor's reforms. But they weren't sure if the changes were working. They immediately asked the former CEO of IBM New Zealand, Basil Logan, to chair a committee to review the changes.

After a five-month review, Logan endorsed Labor's framework. "It has already had a significant and beneficial impact on the effectiveness and efficiency with which the core Service operates," he reported. "The reforms undertaken over the past three years are at the leading edge of central government systems internationally, and should be given an

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opportunity to consolidate before major modifications are contemplated." The Logan report found that in addition to performance improvements, departments were more accountable to ministers and the quality of information given to elected officials had improved considerably.

Logan and others cite the National Party's success in cutting budgets in 1991 as a leading example of the new system's value. Initially, says Scott, the new ministers "tried cutting the old-fashioned way: giving instructions [to the departments] and waving their arms." It didn't work. "They found that the system could absorb that kind of punishment without saving money."

Then the ministers realized they could cut costs by renegotiating performance agreements with chief executives; all they had to do was eliminate or reduce agency outputs. "They found the new system of management offered them new levers they could pull," Scott says. They "went from being skeptics to being believers." Ruth Richardson, the finance minister, became an enthusiastic advocate of the new system.

Although the Logan Committee endorsed the reforms' basic framework, it also pointed out problems that needed work. Among them:

- ministers experienced difficulties in specifying performance objectives for chief executives;
- the central agencies' new roles were ambiguous, there was no way to monitor their performance, and they were not trusted by the departments;
- managers needed to develop new skills required by the new environment; and
- few qualified private sector candidates had been recruited for top management positions.

Most important, Logan reported that the ministers were having trouble steering the ship of state. They had not developed a clear process for articulating their long-term policy goals, so there were no agreed-upon outcome goals to guide them as they negotiated the outputs required of departments. (Outputs are what organizations produce: street sweeping, arrests, social security checks, or job training. Outcomes are the results: clean streets, low crime rates, satisfied senior citizens, and skilled individuals who find and hold jobs.) In addition, because departments were now held strictly accountable for outputs but given great autonomy, their managers had no incentive to focus on any goals beyond those outputs. No one was accountable for pursuing the government's collective interest. All in all, Logan reported, ministers were neither setting long-term, collective goals nor requiring departments to work on achieving them.

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Improving Steering

In response to these concerns, National Party leaders struggled to develop a more strategic management system. First they tried a World Bank strategic planning model, but they found it too complex. They settled on a simpler alternative: the prime minister's political advisor, David Kirk, prepared a government statement setting out long-term goals. In mid-1993, four months before the next election, they published it as *Path to 2010*, a 35-page vision and strategy for New Zealand. It identified general goals—economic growth and social cohesion—and translated those into some measurable outcome goals, such as a 3.5 percent economic growth rate for 15 years.

The government still needed a way to translate *Path to 2010* into specific policies and priorities for departments and ministries, however. Working with the State Services Commission and top managers, it developed a set of threeto-five-year outcome goals—called "strategic result areas"—that would most contribute to its long-term outcome goals. Then it developed more specific outcome goals—called "key result areas"—for each department, which would contribute to the strategic result areas. (These are expressed primarily as outcomes, but some outputs have also crept in.) For each key result, milestones—or targets—were identified with which to measure progress. In early 1995 the government began to test the new system: there were some 40 strategic result areas to guide the government as a whole; about 200 key result areas for the 41 government departments and ministries; and many hundreds of milestones to judge progress. When ministers negotiated the outputs they would purchase from departments, they looked for outputs that would produce the key results they were after.

Aftershock and Aftermath

In 1993 the National Party almost lost its reelection bid, in part because it had forced deep, unexpected budget cuts. Although the economy was beginning to recover, voters were dissatisfied with their political leaders. "New Zealanders had had years of being pushed around by governments which appeared to be doing things for which they had little or no mandate," observes Scott. Both parties had forced deep changes through Parliament without consulting with the public or in contradiction to campaign pledges. By a small margin, voters in 1993 adopted a referendum that made it more difficult for a political party to unilaterally adopt such sweeping changes.

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In the past, the candidate who received the most votes from each electoral district won a seat in Parliament. Winner-take-all systems like this produce electoral landscapes dominated by two major parties, as in the U.S. In New Zealand's unicameral parliamentary system, the party that won a majority of seats controlled both Parliament and the executive, and thus wielded enormous power.

Under the new system, seats are apportioned according to what percentage of the national vote a party wins. Hence minority parties are able to obtain more seats, and it is much more difficult for any party to secure a majority in Parliament. (In October 1996, the first national election after the change, none of the 23 parties running won a majority, though the National Party won the most seats.) The result will be more coalition governments, forcing compromises that will probably slow the pace of change.

Since 1984, one eruption after another has shaken New Zealand's welfare state. Reinvention hit the top of the political Richter scale, upending even the most entrenched government policies and agencies. It changed government's basic purposes, wiping away entire departments and privatizing about two-thirds of the government's commercial assets. It cut total employment in "core" national government agencies from 88,000 in 1984 to 35,000 in 1994. And it caused "a radical refashioning of the departmental landscape," as analysts at Victoria University put it.

Today, a set of small, sharply focused departments dominate the core public sector. Since 1984, the government has created 26 new departments or ministries and abolished, corporatized, or privatized 23. In 1984, only two of the 34 departments and ministries had fewer than 100 employees and a dozen had more than 3,000. By mid-1995, more than a dozen had fewer than 100 staffers and only three had more than 3,000.

It is widely agreed that these changes have contributed to overall economic improvement. The economy turned around in 1991, and by the mid-1990s it was humming. Real growth rates ranged from 3 to 6 percent a year, while inflation remained below 2 percent. Unemployment dropped from 11 percent in 1991 to 6 percent by 1995. New investment was growing rapidly, as were exports. In 1993 the World Competitiveness Report ranked New Zealand first among industrialized nations in quality of government and second in business community optimism.

Rapid economic growth coupled with constraints on government spending yielded a small budget surplus in 1994—New Zealand's first in 17 years and a rarity in the industrialized world. By 1995, government expenditures

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had fallen to 35 percent of GDP. Government-owned businesses, which had once absorbed 12 percent of GDP and 17 percent of national investment while losing money and paying no dividends or taxes, now absorbed only 5 percent of GDP but returned $1 billion in dividends and taxes. By 1996, public debt was down from 50 percent of GDP to roughly 25 percent, and the government was cutting taxes.

Few politicians now question the reforms. "No political party is making a fuss about any of it, really," says Graham Scott, who left Treasury to consult on reinvention around the globe.

Government managers like the changes, too. "There's no constituency for going back to the old system," says Derek Gill, a Treasury official. "You'd much rather be a chief executive under our system than under the old one." Agency executives say their organizations have a sharper focus and clearer missions, and that they must grapple with much less conflict over objectives.

New Zealand's reinvention—once so disruptive—is now embedded in the fabric of government. "It's just the way business is done here now," says Scott.

THE CORE STRATEGY

New Zealand's reinventors moved faster and more aggressively than any others in the world. In the process, they used the entire core strategy. They eliminated or privatized functions that were not consistent with the core purposes of government. They uncoupled functions with fundamentally different purposes—policy, regulation, service delivery, and compliance—and put them in different organizations, so each could more effectively achieve its mission. Finally, the National Party realized that while Labor had redesigned the core public sector, it had not built much capacity to steer the ship of state—to define long-term goals and focus the system on achieving them. Beginning in 1994, its leaders began creating the mechanisms they needed to steer more effectively.

In the process, New Zealand demonstrated the three basic approaches of the core strategy: clearing the decks, uncoupling steering and rowing, and improving your aim.

Why do we call these three approaches the "core" strategy? Because the most important role government plays—its *core* role—is steering. To a

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great extent, the core strategy focuses on improving steering, while the consequences, customer, control, and culture strategies focus on improving rowing. The core strategy helps define what direction you want to go, weed out functions that don't help you get there, and organize your government for the trip. The other four strategies help you reach your destination.

Achieving clarity of purpose, role, and direction does not in itself improve performance; it sets the stage. It creates the conditions for improved performance. One of the clearest patterns we have seen, however, is that once institutions have clarity about their purpose and goals, reinvention becomes much easier. That's why organizations with clear purposes, such as military organizations and revenue departments, often lead the way. It is also one reason why reinvention is easier in parliamentary systems and in local governments. In parliamentary systems the ruling party has the power, with few checks and balances, to clearly define and pursue its purpose and goals. And in small and midsize local governments, there is less political struggle over purpose and goals than in larger governments. Hence it is much easier for leaders to get some degree of clarity.

Intergrating the Three Approaches

There is no correct order of play in unfolding the three core approaches. In New Zealand and the U.K., leaders began by clearing the decks, then moved to uncoupling, then (in New Zealand only) focused on improving their aim. This is the most pragmatic sequence, because it is politically easier to privatize and eliminate functions than to agree on long-term goals and build a system that forces everyone to stick to them. The first approach allows politicians to throw the voters red meat; the second requires them to put reason and the public interest above politics and self-interest.

In a nonpolitical world, however, the logical order would be to get clarity of direction by defining your goals and strategies; then clear the decks of functions that don't fit; then uncouple steering and rowing functions. To be even more logical, only then would one move on to the other four C's. But reinvention is normally driven by necessity, not logic. Reinventors start by solving their most pressing problems—even if they are Labor Party leaders and the most pressing problems include public organizations that should be privatized. The lesson is simple: start where you have the most political will and the best opportunity to make change. But don't forget to come back to the rest of the core strategy. At some point it will become indispensable.

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Steering at the Organizational Level

Because it is about steering, the core strategy is chiefly the province of elected officials and their top appointed officials, whom we call "policrats." However, managers often formulate goals and strategic choices and take them to executives and legislative committees for approval. It is not uncommon for managers to drive the process and elected officials to react and endorse their proposals.

Within their own rowing organizations, managers can also use the core strategy. As much as we talk about separating policy and administration, steering and rowing, the separation is rarely pure. Policy decisions remain to be made in many rowing organizations. For example, compliance organizations have to interpret the laws and regulations they enforce, and service delivery organizations often experience budget reductions that force them to choose which policy goals are most important and which will be given less priority.

Managers can use all three core approaches within their rowing organizations. They can clear the decks of unnecessary functions, though they may have to get the permission of elected officials. They can use all of the tools of the third approach. Indeed, strategic planning was developed more for single organizations than for governments with multiple organizations, and its "planning" side makes more sense in that context. Finally, while they cannot uncouple steering and rowing, they can uncouple purchasing and providing, as the British have done through their market testing system. A rowing agency can purchase services from outside providers, thus splitting the purchasing role from the providing role. But this does not uncouple steering and rowing, as we have defined them. Thus the "purchaser/provider split," as the British call it, is similar to but not identical with the separation of steering and rowing.

Achieving clarity of purpose is a critical first step in any organization. According to Sonia Phippard, former head of the Next Steps Team in the U.K., the executive agencies that have made the most improvements are those that have focused on questions of mission, goals, and performance targets. "There is no doubt that agencies have done better when they have taken the time to think through very carefully their aims and targets," she says, "and how performance measures can be set against those aims."

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Notes

All quotations that are not attributed in the text or in these endnotes are from interviews with the authors or their associates. Only in cases where there might be some confusion about the source of a quotation have we indicated in a note that it came from an interview.

Chapter Four

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