Accountability, Transparency Key to New Zealand Reforms

With sweeping and sustained reforms, New Zealand has recently retooled its economy. A centerpiece of this process has been a bold restructuring of the public sector. How was momentum built and popular support retained? Marco Cangiano, in an IMF Working Paper, *Accountability and Transparency in the Public Sector: The New Zealand Experience*, reviews these reforms and concludes that commitment to transparency and accountability helped win, and retain, public acceptance. It also enabled policymakers, over time, to shift the focus of fiscal policy from short-term stabilization to a framework that encouraged pursuit of efficiency in expenditure and taxation and responsible longer-term policies.

Background

In the early 1980s, New Zealand's fiscal woes resembled those of many industrial countries. Government expenditures as a percent of GDP had risen sharply, and the deficit had ballooned. Moreover, compared to other industrial countries, New Zealand's public enterprise sector played an unusually large role in the economy, accounting for nearly one-third of total employment and managing a substantial range of trading activities. In 1985, when slow growth and chronic and rising deficits prompted the government to take a hard look at the economy, the scope and role of the public sector was a principal focus of concern.

Corporatizing and Privatizing

In 1986, New Zealand took the first step in its reform process. It reorganized its state trading activities around five broad principles:

- Shed activities more efficiently performed by the private sector.
- Run state trading organizations like private companies (and shift noncommercial functions elsewhere).
- Require managers to run their organizations like successful enterprises and hold them fully accountable to performance objectives set by ministers.
- Operate the enterprises without artificial competitive advantage.
- Set up enterprises with specific commercial purposes, with new boards of directors from the private sector.

By the end of 1993, New Zealand had created 31 corporatized state-trading organizations and a number of new agencies to assume regulatory functions. In general, corporatization dramatically reduced unit costs, prices, and tariffs, and improved service and profitability. Much of the increased efficiency derived from managers pursuing clearly defined objectives. Competition offered an important incentive. Between 1986 and 1988, remitted profits and dividends doubled. By 1989, New Zealand had ended subsidies to virtually all state-owned enterprises.

But corporatization also had its shortcomings. The effectiveness of incentives and monitoring devices was limited by the absence of tradable shares and the threat of takeover or bankruptcy. Likewise, the perception of an implicit government guarantee for debt remained, as did the presumption of political interference. Penalties for failing to meet agreed-upon targets were not clearly spelled out. And some state-owned enterprises found themselves at a commercial disadvantage because their social responsibilities affected their bottom line.

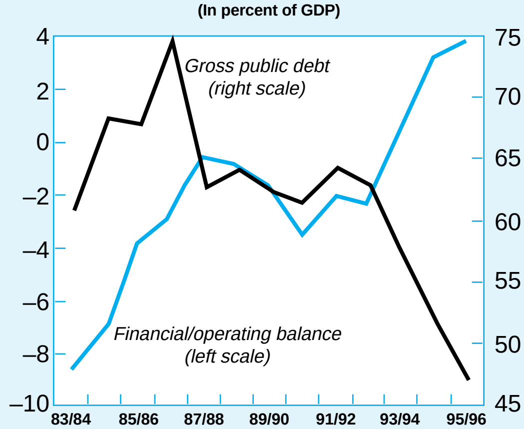
To address these shortcomings and to meet budgetary needs, the government complemented its corporatization effort with a strong privatization push. Between 1988 and 1994, it sold $NZ 13 billion of government assets (including 21 state-owned enterprises)—equivalent to an annual average of 4 percent of GDP. In pursuing privatization, New Zealand opted to accept foreign ownership, even in strategic sectors, in recognition of the small size of its domestic financial market. It also made certain there was competition before a public sector monopoly was put up for sale.

Responsive, Efficient Government

Next, the authorities turned their attention to the second phase: ensuring

New Zealand Fiscal Developments[1]

(In percent of GDP)



[1] Data relate to years ending in June. Starting in 1991/92, financial statements are on an accrual basis and not strictly comparable to the previous cash-based statements. From 1992/93 onward, the reporting entity includes all state-owned enterprises and Crown entities as well as the Reserve Bank of New Zealand.

Data: New Zealand Treasury and Statistics New Zealand that government provided its core services efficiently. In 1987, the New Zealand Treasury recommended that greater attention be paid to the relationship between ministers and the heads of government departments; greater autonomy be granted to department heads; a clear distinction be drawn between the output of services and the desired outcome of a social program; and provision be made for financial accountability.

Legislation in 1988 and 1989 laid the basis for new management relationships and created new methods for ensuring accountability. Department heads became "chief executives" on five-year contracts, accountable for their performance. Government agencies and departments were restructured to rationalize responsibilities and separate policy from operational functions, and funding from the purchase and provision of services. Private providers now competed with public providers.

These operational and organizational changes made the existing appropriation process obsolete. To ensure accountability and managerial efficiency, the new legislation distinguished between outcomes (policy goals) and outputs (the goods and services, including policy advice, needed to achieve these goals). The legislation held chief executives accountable for achieving agreed-upon outputs, while ministers retained responsibility for outcomes.

The quest for improved financial information to support the new asset management led to the adoption of private sector accounting practices in the public sector, including the preparation of annual financial statements on an accrual rather than cash basis. The government also shifted the appropriation system from inputs to outputs and substantially revised its financial procedures to devolve responsibility for managing financial and human resources to the chief executives.

The next step was compiling a balance sheet for the government. This took approximately three years and several phases of legislation, because, notes Cangiano, "no other government had undertaken such an exercise before." Since 1994, the government has been publishing a full set of financial statements similar to those of a publicly listed company.

Ensuring Fiscal Responsibility

In June 1994, New Zealand moved into the third phase—innovative institutional reform that balanced principles of responsible fiscal management with a degree of policy flexibility. The reform, embodied in the Fiscal Responsibility Act, was deliberately designed to provide a strong medium- and long-term orientation to fiscal policy. The reform rejected quantified fiscal targets and instead adopted five principles that serve as legislative benchmarks:

- reduce government debt to prudent levels by requiring fiscal operating surpluses until this is achieved;
- once debt is at a prudent level, ensure that operating expenses do not exceed operating revenues;
- achieve and maintain a sufficient level of net worth as a cushion against future adverse developments;
- manage fiscal risks prudently; and
- pursue a reasonable degree of predictability in the level and stability of future tax rates.

Governments may temporarily deviate from these principles with justification and with assurances that they will, within an explicit time frame, return to them. To ensure transparency and accountability, the law also established disclosure requirements for fiscal policy intentions and objectives. To date, fiscal developments have been sig-naled well in advance, and key ministers have shown awareness of the five crucial fiscal variables: revenues, expenses, accrual operating balance, total debt, and net worth. Transparency and predictability have come to characterize fiscal policymaking, and market analysts and the media have reacted favorably.

Dividends of Reform

New Zealand's reform efforts have improved its fiscal position dramatically. Surpluses have been recorded since 1994, following two decades of deficits. In 1995/96 the operating surplus was 3.7 percent of GDP; net worth turned positive, reaching 3.7 percent of GDP; and net public debt declined to 31 percent of GDP. State-owned enterprises, and the government itself, abide by the same set of rules and regulations (including taxation), disclosure requirements, and accounting practices that apply to the private sector. And the results, in terms of efficiency gains and the dramatic turnaround in the country's fiscal position, are impressive.

Copies of IMF Working Paper 96/122, *Accountability and Transparency in the Public Sector: The New Zealand Experience*, by Marco Cangiano, are available for $7.00 from Publication Services, Box XS600, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; Internet: publications@imf.org

Practical Lessons from New Zealand's Reform Efforts

As the New Zealand experience with government reform demonstrates, comprehensive and fundamental change is possible in a relatively short period of time. Careful planning, observes Graham C. Scott in IMF Occasional Paper No. 140, *Government Reform in New Zealand*, can contain the risks associated with change. Scott served as New Zealand's Secretary to the Treasury from 1985 to 1992. From this vantage point, his Occasional Paper provides a broad review of the reform process, including 12 lessons for countries seeking to implement similar reforms:

• *Recognize the Problem*. For reform to occur, there must be a broad realization that a problem exists, general agreement on a solution, and a strong commitment to pursue this solution despite the inevitable obstacles. Some analysts have argued that only serious crises spawn real change, but New Zealand's experience suggests that ideas and political and bureaucratic leadership can also effect change.

• *Solve a Sequence of Real Problems*. The political reality is that grand designs rarely excite politicians. Keep the end-point in sight and avoid inconsistencies, but emphasize the solution of a sequence of real problems to secure early payoffs and political support.

• *Political Commitment Is Necessary at Key Points*. New Zealand's reforms relied on the leadership of the finance minister and other key authorities. They steered the necessary legislation through the government and parliament, and at other critical junctures conveyed their support to the top management of the civil service. Legislation, although not strictly needed, provided clarity of purpose, a philosophy, and a technical basis to sustain changes over time.

• *Leadership from Heads of Departments Is Essential*. Since opportunities to frustrate reforms abound and passive leadership undercuts momentum, the active leadership and commitment of heads of departments and central agencies are crucial.

• *Do Not Relax Central Controls Too Soon*. Legislation provided departments a two-year period to make the transition from detailed input controls to outputs and finally to free them from most controls. The government was thus able to deal individually with departments and appraise their readiness to remove input controls.

• *Change Management Requires Particular Skills*. New Zealand's reforms enabled managers at all levels to change the way they manage staff and resources, and to be more responsive to clients. The three phases of change management require different management skills. In the first phase, conceptualization, planning, and strategic skills are essential. The key task of the second phase—the early implementation stage—is motivation. In the third phase, as the system has begun to operate, the emphasis shifts to decentralized activities: technical development, staff training, learning from errors, and identifying best practices. Individual habits and attitudes will lag behind changes in systems. Constant reinforcement of the need to change, and of the rewards for doing so, is necessary.

• *Create Incentives to Change*. Department heads welcomed the removal of controls over inputs; it motivated them to implement reforms. When their new duties made them chief finance officer, they responded by bringing in qualified accountants and including departmental finance officers on senior executive teams.

• *Communicate the Objectives of Changes*. Reforms often translated into more work for many people. To keep them motivated, they had to understand how the financial management changes would benefit the government as a whole and their operations in particular.

• *Decentralize Technical Accounting Issues*. Consistent with their commitment to decentralization, parliament and the treasury avoided dictating detailed accounting practices. Within the bounds of the generally accepted accounting principles, variation across departments was tolerated. Subsequently, inconsistencies that appeared material were rectified.

• *Senior Management Must Allocate Time for the Change*. The transition to decentralized management will mean that chief executives have to spend considerable time overseeing the development of new management systems. Until these become routine, their traditional function of providing policy advice may suffer.

• *Manage Traditional Risks Carefully*. Opponents of reform will seize upon early problems in implementation. Scott counsels managing these risks with common sense—anticipating problems and intervening quickly to limit damage and correct the problem. Such problems tend to be less important if the overall thrust of the reforms produces early results.

• *Managing Change at the Departmental Level Is Crucial*. Management change is critical to the reforms. Departmental chief executives became personally responsible for managing strategy, operations, personnel, *(Continued on next page)*

(Continued from page 3) and finances. Some managers who had flourished under the previous system were not capable of taking on such personal responsibility. Assuming competent top management is in place, the change process involves:

• a clear mission for the organization, including corporate values; a commitment to quality; and strategic plans defining priority outputs and the development of the organization;

• operational plans that translate strategies into detailed agreements assigning responsibilities and that specify information flows internally and externally; and

• enabling systems to allocate and develop resources, ensure quality, specify results, monitor achievements, and motivate staff performance and innovation.

Copies of IMF Occasional Paper 140, *Government Reform in New Zealand*, by Graham C. Scott, are available for $15.00 (academic rate: $12.00) from Publication Services, Box XS600, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; Internet: publications@imf.org