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The Hon Bill English

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Good afternoon and thank you for the opportunity to join you here today.

Today I want to take a Finance Minister's view of public sector management over the next 10 years.

As governments around the world strive to tackle the fallout from the global recession, good public sector management will be critical.

Many governments are facing a debt burden they are going to struggle with for years to come. This will place them under constant pressure to deliver similar or better public services for less money.

In Australia, the fallout of the global recession has been mild compared to many other countries - indeed it was the only developed country to avoid recession.

At the other end of the spectrum, countries like the UK and Greece are having to undertake some fairly radical austerity measures to balance their books. New Zealand's fiscal outlook lies somewhere between those of Australia and the UK.

Today I want to talk about the steps we are taking in New Zealand to improve the way our public service operates. But first, I want to touch on some of the economic challenges we face.

Our economic challenges

Some commentators have suggested New Zealand's economy was in good shape before the global recession hit in late 2008.

That is incorrect: In fact, our average annual growth was less than 1 per cent in the three years leading up to the global financial crisis in late 2008 and we went into recession several months earlier, before just about every other developed economy.

Our track record going back several years shows sluggish and unbalanced growth driven by excessive debt, consumption and government spending, rather than savings and exports.

The bottom line is that we need to rebalance our lop-sided economy.

There are two main indicators of our economic under performance.

Firstly, the tradeables sector - the internationally competitive part of our economy comprising exports and import-competing industries - actually shrank in the five years from 2004 to 2009.

Even more alarmingly, there have been no net new jobs created in the manufacturing and agricultural sectors for the best part of a decade.

By contrast the non-tradeables sector - the spending side of the economy - has grown by 15 per cent since 2005.

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

That is unsustainable - no household or business could survive with its spending growth running at twice the rate of its income. And nor can a Government when it is running Budget deficits and surpluses are still several years away.

The second indicator of New Zealand's economic under performance is our net international investment position, which measures New Zealand's total debt to the world, including households, business and the Government.

In 2000, our debt to the world was just over $100 billion. It's now approaching $180 billion and, by 2014, it is forecast to be nearly $250 billion.

So our goal is to move resources to the export and earning side of the economy. That means the Government is likely to be losing jobs, rather than creating them in the next five years.

We have begun the task of rebalancing our economy with an array of changes across a wide range of areas.

As well as demanding more accountability from our public sector, another area of change I want to briefly mention is our tax system.

At a time when many countries are being forced to raise taxes, New Zealand has implemented a major package of tax reforms that cut income taxes across board and reduced company tax to 28 per cent.

From 1 October, every New Zealander earning above $55,000 a year will pay less income tax on a dollar-for-dollar basis than someone on the same income in Australia.

To pay for this, we've increased GST to 15 per cent, increased the taxation of investment property and closed a range of tax loopholes to improve fairness.

These changes have helped increase our international competitiveness and address some of the economic imbalances I've outlined.

Implementing these changes without a public outcry was helped by a fairly open policy development process which I'll talk about later in this speech.

Our fiscal position

The last two years has seen a dramatic turn around in New Zealand's fiscal position.

Following 15 years of government surpluses, our books plunged deeply into the red last year.

And although our economy has now been growing for a year, we are still looking down the barrel of five more years of deficits.

When we get back to surplus, there will still be strong competing demands on Government spending - high Government debt will need to be repaid and, when surpluses permit, we will resume contributions to the New Zealand Super Fund.

Therefore, we are likely to require surpluses of at least 2 per cent of GDP before we even have the choice of significantly increasing public spending.

That is still many years away and may not occur in the professional lives of a large group of middle to senior civil servants.

Our forecasts include an assumption of $1.1 billion annual increases in discretionary spending, plus other forecast spending increases that fall outside this cap. Taken together, they add up to 4.8 per cent real spending growth over the next four years - an average of just 1.2 per cent a year.

It is hard to directly compare this with the Australian Government's ceiling of a 2 per cent real increase in spending, because the New Zealand Government incorporates many of the Australian federal and state government activities under one roof.

However, it gives you some indication of how much tighter our financial constraints are.

In our first two Budgets, we have reprioritised almost $4 billion of spending over five years - about 1.1 per cent of our total spending - to put back into vital frontline services in areas like health, education and law and order.

However, these are the easy savings because they consist of quick wins from the previous decade of loose Government spending.

We now face a far more challenging task - finding further savings so we can improve the quality of our public services within tight fiscal constraints.

The outlook for the public sector

So where will we look for new directions and ideas?

To be frank - they will not come from Australia and New Zealand.

In our countries, the prevailing public management literature and approach is conditioned by a decade of generous year-on-year increases in funding.

However, it is impossible to ignore the fact that globally public sector management is entering its next revolution.

That revolution will be driven by the large economic and geopolitical changes that are taking place as many Western governments grapple with the aftershocks of the global recession.

The public sectors in the countries we usually compare ourselves with - the United States, the UK and much of Europe - will spend the next two decades dealing with the consequences of large government deficits and high and fast growing public debt.

As a result of the global financial crisis, changes that may have taken 20 years to occur will happen in five years.

This is a significant shift.

The last decade was characterised by optimism that smart people using the massive resources of government could transform society. That experiment has run out of money and has little that is genuinely transformational to show for it.

The new experiments will have less aspirational goals - sorting out which public services and income support measures really matter and working out how to do it for a lot less money.

I believe we will see radical changes in the scope and cost of public services in the UK, United States and most of Europe They have no choice.

However, at the same time as the global financial crisis has inflicted large debts on some governments, many fast emerging economies in the developing world are travelling in the opposite direction.

These countries, which are generating large surpluses as their economies rapidly expand, are likely to develop stronger consumer and service economies, along with a demand for more public services.

Most of these countries are starting with low levels of income support and minimal government provision of public services. India and Africa are now developing sufficiently consistent economic growth to stimulate demand for public services.

They too will be looking for solutions and creating experiments.

Australia and New Zealand will not be at the cutting edge of either of these revolutions.

Our role may be to sell our frameworks for accountability and transparency to the emerging economies developing their public services, while borrowing some of the cost-crunching innovations that are developed in the UK, United States and Europe.

Public sector reform

In New Zealand, we are laying the foundations for a public service that chooses innovation and change.

I want to first describe how we are thinking about the next five years and discuss some of the factors we believe will drive further change - as well as the core public sector management system change that will be required.

Faced with fast growing deficits, we have chosen what I call the 'responsibility model'.

As an incoming government, we had a choice to make savings across the board and restructure the public service to get efficiencies.

However, we have left existing structures largely in place, and set out clear fiscal constraints for the next four years. We have pushed responsibility for managing resources clearly on to public sector chief executives, rather than the Treasury or the Minister of Finance.

So rather than embarking on wholesale change, we are stress testing the existing devolved model of public sector management.

There are two reasons for this. The 2008 election was fought in the world before the global financial crisis.

Then, in Opposition, we made undertakings to leave existing income support measures in place, and to focus on moving public sector resources from the back office to the frontline.

This positioning effectively ruled out rationing public services or pushing more cost back on to the public. So that is not a debate we are entering into.

Instead, we are focused on getting value for money from the current level of resources. In this context, we also specifically ruled out large scale structural change and we have kept to those undertakings, despite the change in circumstances.

The second reason is that New Zealand's previous experience of fiscal restraint shows that longer-term effective change is driven by people who know the business, clearly understand the parameters they are working to and have the tools they need to implement change.

So chief executives -not the Cabinet or the Treasury - are responsible for delivering better services and policy advice with less money and fewer people.

This model requires ministers and chief executives to clarify the results they want.

We are using the basic tools of ministerial and chief executive accountability, not inventing new ones. We spend time on the Prime Minister's expectations of ministers, and getting ministers to focus clearly on their expectations of their chief executives.

These expectations are driven off pragmatic political commitments and clearly understood fiscal constraints. This process needs constant reinforcement to maintain focus over time. And it takes time to build momentum.

The culture of caution and risk management in the public sector has been deeply embedded in the last 10 years. So the Government has to keep demonstrating political support for change, and mandating tools chief executives can use without fear of political consequences.

This approach is being reinforced by increased oversight of our largest entities - the 10 departments and entities that make up over 80 per cent of government spending.

It has required a lot of work to merely slow down the strong growth in spending driven by an expansionary fiscal policy, particularly since 2005.

The challenges of reform

In practice, the challenges are predictable.

The first is that everyone in the public sector hopes the rules will change - in particular that politicians won't stick to self-imposed spending constraints.

Some are still trying to wait it out.

However, 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, as New Zealanders are themselves.

So the political case for staying the course, for constraint and better value for money, remains strong in New Zealand.

Secondly, in a devolved system, it takes time and effort to get the balance between collective and individual interests among ministers.

This is more of a challenge in a centre right Government, where ministers tend to come from self-employed or business backgrounds.

Ministers have impressive degrees of freedom to do, or not do things. So it is vital to achieve a strong common understanding of our collective purpose, and to turn this understanding into clearly aligned processes of accountability.

And we need to achieve this within the political timetable of a three-year election cycle.

A third challenge is whether our public management system permits the kind of solutions that are now required.

Solutions such as shared services, joint procurement, or joint decision making across a sector have not fitted naturally into our framework.

In the last 20 years, there have been many attempts at joined up or collaborative government. Most, but not all, attempts have failed because the processes of joining up can be very inefficient and large committees collaborating do not make for strong accountability.

So it's a challenge for the public service to develop strong internal governance to run joint processes - in our case without strong central processes to dictate to them.

In our approach, Cabinet has supported a handful of collective processes for the public sector, such as joint procurement and - beginning soon - administrative and support services benchmarking, as well as shared services in the health sector.

We have also set up an internal infrastructure unit to create better capital management and project assessment.

In each of these examples, chief executives have the choice of picking up the tool and using it, or not.

Progress has been slow to start with. But momentum is now picking up as chief executives understand they will need to take action as they see the growing gap over the next four years (our projection period) between rising costs and flat revenue.

At the same time, voluntary participation in collective initiatives keeps a healthy tension on the proponents to show value for the time and effort.

We are beginning to see more collective activity among these independent chief executives, which shows the public service is developing a sense that it wants to influence its own destiny.

That is because they understand the world has changed and that the only other viable alternative is politicians and the Treasury, armed with public support, going in and finding the savings themselves.

However, the governance of joint back office savings exercises is just a first step.

The next step is to fulfil the theory of our public management system by setting outcomes and structuring accountability and governance around those outcomes.

Currently, governance and accountability are driven by the parliamentary appropriations process. That process accounts for the money, but not the results.

Resolving the tension between parliamentary accountability and effective management for outcomes is one of the biggest challenges for the New Zealand public service. We need far-reaching solutions to make the far-reaching change dictated by fiscal constraint and public expectations.

One example is the criminal justice system. At a time when funding is tight, we have to find ways to foot the bill for tougher sentences for serious criminals, which the public demands. One response is to reduce offending and prosecution and imprisonment rates for less serious offenders.

Over recent years, justice sector agencies have begun to work together to understand better who gets arrested and why, how they move through the police and courts system to prison or otherwise and at what cost.

This has generated at least some initial operational solutions for a more effective and more just system.

But driving these changes further will require something even more difficult than good political management. It will require joint governance and accountability in what is currently a strongly siloed system.

The agencies involved in the justice pipeline have some statutory independence, strong cultures and embedded practises.

The politicians' task is to turn the objective of community safety into some high level outcomes, like reduced prison numbers, or reduced youth offending rates. The public service needs to think about the governance and accountability structure that can drive decisions to achieve these outcomes.

We have any amount of policy analysis and any amount of public support for success. But there is very little accumulated wisdom on what governance and accountability will deliver the desired policy result.

In this sector, as with many others, we simply won't meet the fiscal constraints and public expectations with the current institutional arrangements.

You will hear debate about these issues across a number of sectors in the next few years - long-term welfare, delivery of social services, housing, defence and others.

The evolution of the policy process

The policy-making process itself will be subject to same pressures for change. It will need to be more efficient and better incentivised.

The model of large-standing policy capacity, available just in case the Government needs it, is the product of a time when money was easier.

Since becoming the Government, we have found ourselves using a different model when we needed results.

Instead of relying exclusively on the public service, we've used a mix of officials and people who are experts in their fields - either from the private sector or academia.

That has meant a more open process after a decade of very tight discipline in the public service where officials were not encouraged to think or speak freely, or to take risks.

One example of a more open process is that used in the initial stages of our Budget 2010 tax reforms, which I referred to earlier.

At the start of last year, we decided to take a look at the tax system. Instead of relying exclusively on Treasury and Inland Revenue advice - with the whole process taking place behind closed doors - we took a different approach.

We convened a Tax Working Group comprised of academics, private sector experts and officials, led by Victoria University in Wellington.

We did not prescribe what they could and couldn't look at and we allowed them to publish their work - in real time - as they covered a wide range of topics over several months.

This generated a high degree of media interest and, over several months, the group's ideas were widely discussed and debated by commentators and the public.

This open discussion generated a consensus that there were indeed genuine problems that needed to be fixed.

It was in this context that the Government was able to put in place a fiscally neutral package of reforms that increased GST and the taxation of property - alongside income tax cuts - without causing a public backlash.

I believe this kind of open policy development will become increasingly popular

The barriers to entry into policy development are dropping quickly, as technology makes access to stores of knowledge virtually costless. A teenager can now access synthesised policy thinking on most issues at no cost.

Feedback loops can be set up quickly and cheaply and government can feed the process by making its own data and analysis readily and immediately available - all now possible at reasonable cost.

The public service never experiences the benefits politicians get from being in Opposition. The political process now requires opposition parties to develop a range of detailed policy and implementation plans in order to compete credibly in elections.

The National Party put together over 100 specific undertakings, a multi billion dollar tax cut package, general direction for a three-year term and a detailed first 100-day plan - all with just three policy advisors.

Of course, good public policy is underpinned by a professional public service with its inherent continuity and institutional knowledge - but not at any cost, and not as an excuse for inertia.

Public service management of knowledge is neither as specialised nor as uniquely ethical as is often presumed.

I believe a more open policy process - with the potential to engage a wider range of people and institutions and encourage more public discussion - can help address some of these problems.

And, as our experience with the Tax Working Group shows, it can inject a higher level of energy into the policy process, provide a stronger focus on what matters and ultimately get better results.

Conclusion

The last decade has seen an excess of cash and confidence in the public sector. The results of large dollops of both are not impressive - government is bigger, but core social problems remain intractable, and voters are sceptical that their cash has been well used.

The benign economic conditions of the last decade will not occur again for decades, so we face permanent fiscal constraint.

Ask this question: Has the way we think about public services and public policy changed as rapidly as the world around us? The answer is no, not yet, but larger forces of economics, technology and public demand mean our thinking will have to change.

In New Zealand, we have chosen a path of considered and consistent change over time and engaging the leadership of the public service in the mission of significantly changing the way we do business.

I am confident that if we use the tools available, and draw on a wider range of resource outside the public service, we will succeed in the immediate task of meeting reasonable public expectations with fewer resources.

We also have a larger obligation to the next generation. Fewer of them will be supporting more of us as we leave the workforce.

The cost of inertia and inaction will be a double burden of large public debt and an ageing population. We owe it to them to innovate, to take risks, to push the boundaries and to pay our own way. The clock is ticking.

Thank you.