

# By ACCIDENT or DESIGN: Changes in the

## Structure of the State of New Zealand<sup>i</sup>

### Introduction

Discussion of the New Zealand experience with the public sector reforms of the 1980s and 1990s has emphasised fragmentation of the structure of the state under so-called new public management. The first sentence of a leading standard textbook, *Government Administration* (Polaschek), reads as follows:

In New Zealand – a country of a few million – the work of government administration is shared by forty one departments of state and almost one thousand local authorities, government sponsored companies and public or semi-public corporations.

The only surprising thing about this quotation is that it dates from 1958, when New Zealand's population was two and a half million.<sup>ii</sup> In 2007, with a population of over four million, the work of government administration was shared by fewer than 350 organisations (excluding schools and subsidiaries), around 25% of the 1958 total.<sup>iii</sup>

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This article will try to sort out myths from realities by exploring three broad questions:

- Has the state in fact become more fragmented?
- What is the evidence about the effect of structure on performance?
- What do the likely future trends imply for the structure of the state?

### Fragmentation of the state?

New Zealand has a long history of creating single-purpose ad hoc bodies, and often these have been very small. This predates the new public management reforms of the 1980s and 1990s and indeed continues into the early 21st century. So has the state become more fragmented?

The short answer is that, other than for the most recent period, we don't know. The longer answer is that we don't know because in order to answer the question, 'fragmentation' needs to be clearly defined and consistent data should be used to delineate what constitutes the state. Fragmentation is relatively easy to measure: it refers to the number of separate administrative units in the government system, and that includes vertical structure (the number of tiers) and horizontal structure (the number of organisational units within a tier).<sup>iv</sup>

The harder part is that there is no consistent historical definition of what constitutes a public body that is part of the state. The notion that Fonterra is part of the state would be greeted with derision and incredulity in 2008. The view that the same legal body (the Dairy Board) was part of the state would have been a statement of the obvious in 1936. The introduction of accrual accounting, which required the

creation of the Consolidated Crown Financial Reporting Entity, provided a consistent basis for defining central government. Since 1991 consolidated government accrual accounts have been available, but no historical time series exists prior to that.

History does enable us to draw some conclusions about trends in the state sector (and hence the degree of fragmentation). In summary, the long-term trends in the structure of the New Zealand state include:

- '[a] large number of small departments and a small number of large departments' (Schick, 1996, p.28), so the overall number of departments is consistently high by international standards (40-50);
- a propensity to create ad hoc arms-length organisations (in 1984, 25% of state sector employees worked in departments; by 2007 the proportion had fallen to 20%);
- a propensity for restructuring: of 41 departments in 1957, only 21 existed in 1995 (often with changed functions and names).

Within these longer-term trends there were some significant changes:

- growth in the number of ministerial portfolios, from around 20 in 1912 to 58 in 2007 (together with 14 other responsibilities and 37 associates);
- consolidation in local government, from 850 mainly single-purpose authorities in 1989 to 74 territorial local authorities and 12 regional councils;
- shedding of commercial functions from departments in the 1980s (via the creation of state-owned enterprises and privatisation) and 1990s (e.g. the Public Trust, Valuation New Zealand and Learning Media).

New Zealand's administrative history can be broken up into three phases:<sup>v</sup> 1912 to mid-1984, the period from the introduction of the initial public service reforms through until the 1984 election; mid-1984 to late 1999, which was the period of extensive public sector reform; and late 1999 to today.

#### **Phase one: 1912–1984 – governance by hierarchies**

Throughout the period until mid-1984 the state played an active role in the economy, providing commercial services often through trading departments or local government enterprises.

Local government was a creature of central government, consisting of a plethora of single-purpose organisations with a prescribed and narrow mandate. The role was limited to a defined set of local service functions ('roads, rubbish and rats') and some commercial activities (e.g. port services), with central government undertaking a number of functions which in comparable jurisdictions would be in the domain of local government. These include providing fire services, policing, public schooling and public hospital services.

Central government consisted of a Cabinet of up to 20 ministers and a greater number of portfolios, served by 35-45 departments of state and a plethora of non-departmental public organisations. Over time the relative

share of central government employment accounted for by ministerial departments shrank from 39% in 1949 to 35% by 1971, and 25% by 1984.<sup>vi</sup> Despite a royal commission on the state sector in the early 1960s, no consistent design principles or meta-design were employed. There were repeated unsuccessful attempts to improve the performance of individual commercial functions (such as the railways) by moving them into a corporate form. In Julian Le Grand's terminology, this was a state where providers were viewed as 'knights' and consumers as 'pawns'. In summary, the structure of the state 'morphed', or in the words of the title of this paper it emerged 'more by accident than design'.

#### **Phase two: 1984–1999 – governance by markets and contracts**

The period after the 1984 election was an era of significant change in both central and local government. In central government the initial changes were concentrated in the commercial departments but subsequently extended to the entire public sector, with:

- the separation of commercial and non-commercial functions and the break-up of trading departments;
- the creation of state-owned enterprises (SOEs);
- the creation of the concept of Crown entities;
- the Cabinet increasing in size and the number of departments remaining broadly stable but the number of Crown entities growing significantly.<sup>vii</sup>

The central government reorganisation and restructuring was based on a set of machinery-of-government principles:<sup>viii</sup>

- separation of ownership and purchase;
- separation of policy from operations;
- separation of policy from purchase and provision;
- the introduction of competition; and
- reallocation of function for focus, synergy and transparency.

One can argue about the consistency with which these were applied, but there was no doubting the existence of a comprehensive design over this period.

It was also an era of significant local government reform, with the consolidation of single-purpose organisations into multi-purpose bodies to serve defined areas. This resulted in the amalgamation in 1989 of around 850 organisations into 86 local bodies plus a handful of subsidiary bodies, such as the Auckland Regional Transport Authority.

There was also a greater emphasis on citizen service users as 'kings and queens' rather than 'pawns', and concern about monopoly providers acting as 'knaves' rather than 'knights'. There was a changed role and reduced ownership by the state of commercial activities.

#### **Phase three: 1999–2008 – mixed governance by networks, hierarchies and communities**

Recent developments are always more difficult to characterise as they are still evolving. Although some authors, such as Chapman and Duncan (2007), explore the suggested

emergence of a 'new' New Zealand model, overall the evidence basis for this is weak (see also Boston and Eichbaum, 2007). While it is clear what the government is moving away from, it is less clear what institutional design principles are being used. This article explores this matter with regard to the structure of the state.

One significant change was in local government, with the move from specific narrowly-defined function to in effect giving local authorities a general power of competence. Local authorities are now charged under the new Local Government Act 2002 with pursuing four broad 'well-beings' or outcomes – social, cultural, economic, and environmental in the context of sustainable development. No significant central government functions or funding have been devolved, however. Local government in June 2007 employed 12% of the total public sector workforce and historical SNA data suggest that local government expends between 10 and 15% of final government consumption. Note that one potential effect of the reforms would be to increase vertical fragmentation by introducing an additional layer of government into areas where traditionally only central government interacted directly with civil society.

In terms of central government, there was a distinct change in the rhetoric following the 1999 general election. Whether that rhetoric is reflected in reality on the ground, however, is arguable. There were modest moves towards devolution and decentralisation, such as the local government reforms discussed above and the health reforms, with the increased potential for local voice through local representatives on district health boards. In other areas, however, the trend has been opposite. In education, for example, local autonomy of schools has been reduced with the removal of direct resourcing. In workers' compensation (ACC) the limited scope for provider choice for the earner's account was removed. One clear trend is for a reduced role for competition in quasi-markets in a number of sectors, such as health.

So what appears to underpin the patterns of the structure of the state? Is there an intelligent design evident behind the changes since 1999, or is the structure now morphing by accident as it did for most of the 20th century?

To address this question this article presents an analysis of the changes in the structure of central government since 1999. It does not include changes, often triggered by a new chief executive, in the way an agency organises itself internally. Instead, it focuses on external Cabinet-mandated

**Table 1: Consolidated machinery-of-government changes, 1999-2007: summary of results (excluding name changes)**

Numbers of Agencies (2007)	Department (40)	CE and 4th Schedule (137 excluding schools, subsidiaries)	SOEs (18)	Total (excluding name changes)
Change in form	2	31	3	36
Function change	0	12	2	15
Merge/break up	6	26	4	36
Total turnover	8	69	9	86
Change in form %	5%	22%	17%	18%
Function change %	0	9%	11%	8%
Merge/break-up %	15%	19%	22%	18%
Total turnover %	20%	50%	50%	44%

changes in the structure of central government. All the external central government machinery-of-government changes between April 1999 and July 2007 are classified into changes in legal form, merger and demerger, and new function/function disestablished. (More detail on the analysis and supporting data are available in a separate paper from the author.)

The data in Table 1 are consistent with 'muddling through' in that there is no apparent pattern to the changes in the machinery of central government. Key conclusions include:

- Fragmentation: a small (5%) net reduction in the number of organisations – largely accounted for by consolidation in the tertiary education sector as four colleges of education and a number of small polytechnics were merged.
- Departments: the number of departments has witnessed a small decline (to 40) but remains in line with the long-term level over the 20th century.
- SOEs: traffic in both directions, with commercial objectives replaced by less commercial objectives (e.g. TVNZ and ACC/At Work) but other commercial activities moved to SOE status from Crown entity company status (e.g. Animal Control Products, Learning Media, Valuation New Zealand).
- The Crown entity sector faced the greatest change (50% turnover since 1999), with many mergers and changes in legal form.
- No preference for a particular legal form: for instance, since 1999 three functions have been moved *into* departments from Crown entities (the Special Education Service into the Ministry of Education, the Building Industry Advisory Council into the Department of Building and Housing, and the Casino Control Authority into the Department of Internal Affairs) and four moved *out of* departments (the Public Trust, the Energy Efficiency and Conservation Authority, the Tertiary Education Commission and the Office of the Auditor and Controller-General).
- Existing public sector organisations taking on or shedding function explains little of the change (8%).
- Active use of change in legal form as well as mergers and break-ups (both 18%).

The key trend was not reform leading to the reduction in fragmentation, but rather the extent of change, with 44% of state sector bodies subject to Cabinet-approved external restructurings.<sup>ix</sup> In addition, more than half of departmental chief executives restructured their organisations within

the first year of their appointment. Such is the scale of restructuring that a recent survey commissioned by the State Services Commission (SSC) showed that in 2007, 55% of state servants reported that 'their organisation had been involved in a merger or restructuring over the last two years'. The interesting thing about this result is that for the identical survey question in the United States, the corresponding number was 18%.

One area where there has clearly been no significant reduction in fragmentation is in the structure of Cabinet. This is important as in New Zealand, unlike other comparable jurisdictions, there is no direct rule linking ministers and their portfolios to departments. Thus, there are a number of configurations possible. The most common is one department and many ministers, but we also observe one minister to one department and occasionally one minister to many departments.

**...there is little evidence of any improved performance from the restructuring, despite a significant increase in spending over the period.**

In February 2008 there were 19 Labour Cabinet ministers, one non-Labour Cabinet minister, two non-Labour ministers outside the Cabinet and six Labour ministers outside the Cabinet. But most notable is the number of discrete areas of ministerial responsibility. This currently totals 109, with 58 ministerial portfolios, 14 other responsibilities and 37 associate ministers. Moreover, these portfolios are often fragmented across multiple players. In the justice sector, for example, there are seven departments, six Crown entities and seven ministerial portfolios (including other responsibilities). The latest Cabinet reshuffle (in November 2007) did, however, cluster all the portfolios that relate to innovation under one minister, which has improved the priority setting and alignment for the relevant entities.

These multiple ministerial roles and portfolios are important because they significantly complicate the problem of coordination and priority setting. The bigger the numbers, the greater the problem. Network theory shows how adding one more node increases the number of connections exponentially. There is an old adage of public administration that 'the government gets exactly the amount of co-ordination it wants'. In the case of New Zealand, fragmentation begins at the top.

#### **What is the evidence about the impact of structure on performance?**

One of the striking features of the academic literature is how little is actually known about institutional design and how little agreement there is on the link to performance. As Boston

et al. (1996, p.70) observe, 'There is no scholarly consensus on these questions with opposing doctrines offering opposite prescriptions.' These doctrines or 'administrative arguments' can be expressed with considerable over-simplification as a contrast between proponents of 'small is beautiful', who emphasise the gains from 'focus' and specialisation, and advocates for 'big is better', who express concern about the effect of 'fragmentation'. Concerns expressed about fragmentation at the organisational level include:

- loss of economy as larger scale provides lower unit costs;
- loss of efficiency as larger-scale units are better able to coordinate activities and prioritise across activities; and
- loss of effectiveness as larger units are more resilient, have a deeper capability and are able to invest in learning.

Proponents of 'small is beautiful' counter with concerns about the lack of focus of monolithic conglomerates, resulting in:

- loss of economy as larger span of control leads to higher cost above a tipping point;
- loss of efficiency as larger units with multiple and sometimes conflicting roles are difficult to oversee, leading to organisational slack; and
- loss of effectiveness as smaller units have greater adaptability because parts can innovate and learn from each other.

These contrasting views were framed in terms of organisational performance. How does the overall performance of the system as a whole stack up? The World Bank has developed World Governance Indicators (only available since 1996) to compare country performance in government effectiveness, regulatory quality, corruption control, rule of law, political stability, accountability and voice. These measures consistently place New Zealand in the top group of up to seven countries on all governance measures. This is reinforced by the 'Kiwis Count' survey data (SSC, 2008) released in April 2008, which show that New Zealanders' experience of public services is comparable to that of Canada, a well-regarded jurisdiction which also featured in the top tier on most but not all of the World Bank Governance Indicators. This is consistent with the conclusion of public sector management reviews which suggests that, while as always there is room for improvement, New Zealand has been relatively well served by its system of public management and the staff who work within it.

More importantly, the other states consistently in the top group on the World Bank Governance Indicators – Denmark, Iceland and Sweden – are all relatively 'fragmented', with a clear structural separation between policy ministries and delivery agencies. Correlation does not imply causation, but casual empiricism does not support the notion that fragmented systems necessarily are the low performers.

The analysis of the structure of the state over the last decade presented in this article showed that the key trend was not reforms leading to the reduction in fragmentation, but rather continued change and restructurings. This raises

questions about the available evidence about the impact of restructurings on performance.

Internationally there is limited empirical evidence on whether public reorganisations improve performance. As one author has observed, ‘while few rigorous evaluations have been undertaken, the large number of informal studies have been consistently *negative*’ (Downs and Lackey, 1986, p.185). Similarly, the private sector experience is that costs of change are higher, benefits are smaller and they take longer to be realised. ‘Restructuring is a powerful but high risk tool for organisational change. In the short term, it almost invariably produces confusion, resistance and even a decline in effectiveness’ (Bolman and Deal, 2003, p.92).

Little New Zealand evidence is available, with the notable exception of commercialisation. One key trend since 1984 has been the move of commercial functions into commercial structures. Available reviews of New Zealand experience with commercialisation are generally positive.

One of the few New Zealand examples where an evaluation was explicitly commissioned as part of a restructuring was reforms of the health sector embodied in the Health Services Act 2001. It showed ‘no dramatic impact ... on performance’ (Mays et al., 2007). The overall summary concludes that while the reforms have been very successful in achieving better sector buy-in, there is little evidence of any improved performance from the restructuring, despite a significant increase in spending over the period. There are at least two possible interpretations of this result: either it is too early to tell, or business as usual. The evaluation finds some support for the too-early-to-tell view: ‘a large part of the period covered by the evaluation can justifiably be seen as the establishment phase of the new system’ (ibid.); but much of the argument is also consistent with ‘business as usual’ and ‘continuity with the previous period’. In the latter view, the changes to the formal governance structure did not impact upon the real determinants of system performance.

This raises an apparent paradox: there is limited agreement or evidence on the impact of restructuring on performance (excepting comprehensive commercialisation programmes), and what exists is generally neutral or negative. But at the same time SSC data suggest that nearly 50% of state servants in New Zealand have been through a restructuring in the last two years. What explains this apparent paradox? This paradox raises the possibility that change is based on hubris in the sense of pretence of knowledge that doesn’t exist, or inadequate understanding of the complexity of organisational dynamics. One possible explanation is that the objective with restructuring is not to improve performance directly. Instead, it may be better understood as symbolic rhetoric used to justify change.

Organisational change can be used to signal the ‘illusion of progress’. The famous apocryphal quotation often

attributed to Petronius in 210 BC (Downs and Larkey, 1986, p.184) makes the point well:

We trained hard ... But it seemed that every time we were beginning to form up into teams we would be reorganised. I was to learn later in life we tend to meet any new situation by re-organising; and a wonderful method it can be for creating the illusion of progress while producing confusion, inefficiency and demoralisation.

**These are big challenges even for a state with highly effective government like that in New Zealand. In general, the challenges are not amenable to central bureaucratic Newtonian machine-age solutions.**

#### **Conclusion – what do the likely future trends imply for the structure of the state?**

The government of the future will face increased competition and interdependence, and developments are increasingly complex, multi-sourced and multifaceted (OECD, 2001). Looking ahead, the next generation of issues could include:

- internationalisation – we can’t do it on our own; both competing and working with other nations (e.g. regulation of therapeutics);
- responsiveness to ageing and more diverse populations (e.g. Pasifika and Asian people in Auckland);
- technology enabling changes (e.g. personalisation of services);
- increased expectations of generations Y & Z for individualised services;
- effectiveness (making a difference) not efficiency (doing more with less); and
- the ‘wicked’ problems and opportunities – gangs, family violence, drug abuse – being hard, unstructured, chaotic problems.

These are big challenges even for a state with highly effective government like that in New Zealand. In general, the challenges are not amenable to central bureaucratic Newtonian machine-age solutions. These are soft systems problems which require leadership and changes in styles of working rather than changes to hard systems like structures.

Responding to these challenges will require sophisticated responses, such as establishing networks to address cross-cutting issues. This will place a premium on established relationships and increase the costs of the ceaseless restructurings that undermine those relationships. The main learning for New Zealand is that we will need to be cautious

about the use of the restructuring lever, an idea of the early 20th century, if we want to get on and address the problems of the 21st century.

- i This is a shortened and edited version of a paper presented at the 'After the Reforms' symposium in Wellington, 28-29 February 2008, hosted by the School of Government at Victoria University.
- ii The original text had 'two and a half million' not a 'few million'.
- iii Forty departments, 197 other central government bodies (excluding schools and subsidiaries) and 86 local bodies. It is not entirely clear how Polascheck estimated 1,000 government organisations in 1958 (and hence whether subsidiaries and schools were included).
- iv An alternative measure of fragmentation is the degree of concentration, but there is no readily accessible data to measure trends in central or local government concentration.

- v Polascheck (1958) provided an account of the evolution of the state from 1833, with early Pakeha settlement, through one omnibus department – the Colonial Secretary's Office – in the 1840s through to the structure of the 1960s. The report of the Royal Commission on the State Services (the McCarthy commission), 1962, and Boston et al. (1996) provide a summary of more recent developments.
- vi The corresponding number in 2007 is around 20%.
- vii The author estimates that 50% of current Crown entities' and departments' formation post-dates 1984: e.g. 50% of Crown entities in existence in 2007 were incorporated before 1984 and around 50% of current departments also existed at that time (albeit with functions gained or lost).
- viii See Scott (2001, p.21) and Boston et al. (1996, p.86) for a discussion.
- ix Comparable data from Norway (Lagried et al., 2008) shows a similar level of restructurings, with 55% of public bodies in Norway being restructured between 1995 and 2007 compared to 44% in New Zealand over the period 1999–2007. Unlike New Zealand, in Norway these changes were dominated by break-ups and mergers.

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