WITH PUBLIC-SECTOR DEBT THREATENING the economic, fiscal, and social stability of countries around the world, government leaders are under tremendous pressure to make hard decisions on public expenditure. Yet the record of government action on this front is at best mixed. The Boston Consulting Group’s global research shows that a significant majority of expenditure reduction efforts, even those perceived to be successful, have had little impact on governments’ cost base. Two exceptions are initiatives in the State of Victoria, in Australia, and New Zealand. Victoria successfully cut government expenditure by 10 percent over three years in the 1990s; in New Zealand, an innovative approach to budget management has led to a remarkable record of cost containment since 1990.

To be sure, both Victoria and New Zealand implemented what are now generally regarded as best practices in public-sector management, including the privatization of state assets, outsourcing, and increased human-resource and financial transparency and accountability. But both governments went beyond conventional practice. In Victoria, the government was able to make rapid and effective cost reductions by applying a distinctive decision-making model and actively building support across many constituencies. And New Zealand implemented a unique budget process, resulting in a highly disciplined approach to expenditure. For government leaders looking to tackle stubborn and ballooning budget deficits, the experiences of both Victoria and New Zealand exemplify powerful new approaches.

Rapid and Aligned Action

By the early 1990s, it was clear that the State of Victoria was facing a crippling economic and fiscal crisis. In 1992, the annual budget deficit had climbed to $2.2 billion, pushing total government debt to a record $31 billion. But when Jeff Kennett’s government came to power that year, it was armed with a fully developed battle plan to tackle the fiscal challenge. Having served in opposition for eight years
with essentially the same team, members of the incoming cabinet knew and trusted one another. They took office with a blueprint for action that included detailed plans for the first 10, 50, and 100 days, as well as fully drafted legislation ready to be enacted. In the first three weeks alone, the Parliament of Victoria passed 37 bills.

At the core of the government’s actions were several guiding principles. First, the pain of the crisis had to be broadly experienced in order for everyone in the state to appreciate its severity. There would be no sacred cows: all areas were subject to cuts. At the same time, action needed to be swift, with radical changes made early to take advantage of the new government’s hefty political capital.

With that mindset driving decisions, the government’s cost-reduction strategy had two critical elements. First, goals were set from the center, yet individual departments were free to identify the optimal way of meeting them. And second, the central government ensured that all stakeholders—from politicians and public servants to the general public—had a role in addressing the problem, anticipating that alignment of purpose would help avert a paralyzing backlash.

Rigid Goals, Flexible Approaches
Striking the right balance of power between central agencies (the Department of the Premier and Cabinet and the Department of the Treasury) and line agencies (individual departments) was critical. Members of the Kennett government had studied the history of cost reduction techniques well before coming to power and had concluded that centrally imposed cost-cutting regimes simply did not work. So the government gave line agencies significant autonomy in determining how they would meet their cost targets, rather than driving cost initiatives from the center. But the goals set by the center—10 to 15 percent cost reductions across every government department—were aggressive and firm.

The government’s key mechanism for managing the process was the central Budget and Expenditure Review Committee (BERC). BERC had existed in various forms in the past, but now it was vested with enhanced power and responsibility to tackle the fiscal crisis. The committee was chaired by the state’s treasurer, Alan Stockdale, and reported weekly to the cabinet. Given the urgency of the situation, ministers and department secretaries were given four weeks to develop savings plans for submission to BERC. The committee’s job was not to identify specific alternatives or make line-by-line savings suggestions, but rather to challenge the ministers and department secretaries on the feasibility of their plans and the tradeoffs they had made.

BERC’s oversight of the budget process was intense, requiring ministers, secretaries, and other senior department officials to appear and undergo rigorous questioning by BERC ministers. The goal: to determine whether each department’s plans could meet the established financial goals while still delivering essential programs and services. Failure to reach those goals was not an option: early in the process, a department secretary who failed to produce a plan that met cost reduction goals found himself quickly dismissed.

Empowering department secretaries, who had a firm grasp on the real-world impact of budget cuts, to craft the plans rather than having them dictated by the treasury was highly effective. Not only did it create real ownership of the plans by department leaders, it also ensured that the proposed expenditure reductions were entirely feasible.

Building Broad Alignment
Just as crucial was the strategy for ensuring broad support for the deep and rapid cuts. At the political level, the premier kept the government constantly aligned and on message by enforcing consequences (such as demotion) for ministers and parliamentarians who failed to publicly support the government’s line.
When it came to the public service, the premier made it clear that department secretaries worked for the government as a whole, not just for their individual ministers. For example, employment contracts for department secretaries were held directly by the premier, who took primary responsibility for these officials’ performance evaluations. In addition, a new State Coordination and Management Council regularly brought all department secretaries together with the premier to foster a whole-of-government approach to issues and to prevent a narrow department focus. The government also conducted extensive town-hall-style meetings with public-sector employees, particularly those on the frontlines, such as nurses, teachers, and police. The treasurer made sure that public servants understood the enormous fiscal challenge and how the cost of debt was hampering the government’s ability to deliver services. The message was unambiguous: cuts were needed throughout all departments, and unless government tackled the financial crisis head-on, the state would be trapped in a growing debt spiral.

The third, and in some ways most critical, group of stakeholders were the citizens of Victoria. As part of communicating to the public just how grave the fiscal situation was, the Kennett government instituted a $100 per household debt-reduction levy. While the total amount raised was modest—about $173 million per year—the levy sent a clear message that everyone needed to make a sacrifice to solve the problem.

A Transformed School Sector
The ways in which the state’s education system changed in the wake of the reforms exemplify the effects of the government’s approach. In Victoria, from 1988 through 1991, the school system’s average total expenditure per student was 10 percent above the national average. The system had a bloated cost structure driven by high salary costs, and falling enrollments at many schools resulted in low economies of scale. A two-pronged strategy was needed: reducing the number of schools and improving both educational results and the quality and efficiency of school administrations.

To develop a plan for reducing school numbers, 250 local task forces were created—comprising parents, department officials, and school and community leaders—to formulate a rationalization plan for each local area. The task forces were charged with developing plans to meet a number of centrally set core principles. These included minimum school size and the breadth and depth of curricula. A total of 855 schools were examined, and 85 percent of the task forces’ recommendations were adopted, including 171 school closures and the merging of many other schools. At the same time, a new program called Schools of the Future empowered school councils to set policy and approve budgets, while also increasing parent and community participation. Pushing more control to the local level made it possible to reduce the central department staff from 2,300 to 600. The school reduction drive, coupled with the trimming of the central education staff, produced $250 million in annual cost savings.

The success of the Kennett government’s assault on the state’s runaway budget was noteworthy. Overall government expenditure, which had peaked at $16.3 billion in 1993, was reduced by more than 10 percent to $14.8 billion by 1997 (in real terms), and expenditure as a percentage of government receipts fell from 110 percent to 89 percent over the same period. Reversing the rise in government spending and initiating the privatization of assets allowed the government to pay off state debt, which fell from $32 billion in 1993 to just $4 billion by 2000. The turnaround was widely recognized in the public markets, with Victoria regaining its coveted AAA credit rating in 1998.

Embedding Fiscal Discipline
The budgetary challenges facing New Zealand in the early 1980s took root during a period of tremendous economic
The preceding decade had brought a series of hits to the New Zealand economy, including a shrinking agricultural sector (which had accounted for 90 percent of the country’s exports), oil price shocks, and a 50 percent decline in New Zealand’s terms of trade. The government’s response had been to prop up the economy, provide industry subsidies, keep a lid on unemployment through trade protection, and institute a generous pay-as-you-go retirement system. The results, however, were high unemployment, declining living standards (falling to twentieth in a ranking of 24 OECD nations), a spike in inflation to more than 10 percent, and a decades-long run of government budget deficits.

The first step in putting out the fiscal fire was to reform New Zealand’s economy. Under successive Labour and National governments that shared a philosophy of liberalizing the economy, wide-ranging steps were taken, including floating the New Zealand dollar, removal of all price controls, introduction of competition in the financial markets, and the dismantling of agricultural subsidies. State-owned enterprises across all sectors, including banking and telecommunications, were privatized, garnering $13 billion from sales proceeds from 1988 through 1993. The labor market was deregulated, and human-resource policies in the public sector were transformed to push more decision-making power to the department level, giving department chief executives more management latitude, as well as more accountability in running their organizations. And within six weeks of taking office in 1990, the National government instituted deep cuts to public expenditure.

These sweeping changes were critical steps in moving New Zealand away from the fiscal precipice. But what stands out as sustaining New Zealand’s comeback was the Fiscal Responsibility Act, which set a new standard in sovereign fiscal management. The 1994 legislation imposed a set of requirements that compelled government to be transparent and strategic in setting a fiscal plan for the country. This new approach had two powerful levers. First, government departments were given a fixed, nonindexed budget every year for running their departments (with separate formulas for indexed and demand-driven expenditures such as welfare benefits). The message was clear: departments were expected to find ways to boost their productivity to offset any increases in personnel, operating, and capital expenses. It was possible to request more funds through the review of an interdepartmental committee. But appealing for more dollars carried a risk: an appeal could—and did, in at least one case—result in a reduction in the department’s budget.

Second, the legislation imposed remarkable discipline on the national budget-making process. A “fiscal rules” mechanism was established whereby government was required to outline the fiscal target for a three-year period, that is, one parliamentary election cycle. The treasury advised the government on the target as part of a three-year fiscal strategy that factored in the government’s operating balance, debt level, and expense pressures. With departments having essentially flat budgets, any changes to existing policy or any funding for a new policy would need to be prioritized in a way that still would allow the government to meet the overall expenditure target. The new mechanism—combined with requirements to publish full and frequent fiscal updates, articulate a fiscal strategy, and release up-to-date accounts six weeks prior to an election—dramatically changed the context in which fiscal policy was conducted.

The power of these two levers cannot be overstated. At the departmental level, they removed uncertainty about future budgets, permitting better planning for efficiency improvements and capital investments. The levers compelled the government to find the right balance between short- and long-term planning and forced more active prioritization of spending proposals. And they created unprecedented transparency, putting the government’s three-year plan out for public scrutiny.
The result for New Zealand was a decade-long run of financial control and cost containment, with government expenditure staying below 1990 levels for more than a decade. That disciplined-spending record led to the reduction of government debt as a percentage of GDP from 51 percent in 1990 to just 21 percent ten years later. And New Zealand’s credit rating, which had slipped to AA– by 1991, recovered to AA+ by 1996.

The successes of Victoria and New Zealand in bringing about fiscal stability offer powerful lessons to leaders around the globe. It is not enough simply to wield the axe on government infrastructure and services. These stories show that government leaders can bring about effective and sustainable fiscal management by giving public-sector workers room to innovate and own change, create wide alignment, and embed a system that imposes budgetary disciplines and transparency. With these elements in place, lasting fiscal reform has a chance to take hold.

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