

Public Management and Administration

An Introduction

Third Edition

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Strategic Management

Introduction

The traditional model of administration was criticized earlier for its inward focus and short-term perspective. Both of these shortcomings have altered with the advent of public management, and the public sector now shows more concern with longer-term strategy than ever before. The strategic perspective considers the organization in its external environment; it aims to specify clear goals and objectives; it attempts to move away from routine management tasks to consider, in a systematic way, longer-term considerations of the very future of the organization. Strategy addresses 'a crucial concern: positioning the organization to face an increasingly uncertain future' (Nutt and Backoff, 1992, p. 58).

The traditional model of public administration required little conception of strategy; serious forward planning was either not carried out or carried out in rather limited ways. Indeed, strategy of any kind would have been considered 'political', if thought of at all. Public servants 'administered' in the dictionary sense set out earlier, simply carrying out instructions of the politicians. It is and was possible to *administer* without a sense of strategy, without any idea of optimizing resources to gain objectives, and to follow instructions without any external focus. The traditional model missed out on the longer-term perspective and, by being preoccupied with process, often forgot there was a larger purpose, an overall goal, for any public organization.

Using strategic concepts in the public sector is one way to address these shortcomings. It was realized that those presumed responsible for strategy – the politicians – may not always be in a position to provide long-term strategic leadership for the public organization. If public managers are to be responsible for results there needs to be thought given to how they can aggregate into the overall purpose or mission of the organization. Therefore, a key part of the managerial programme is to determine overall strategy and set objectives, not just by governments, but by the agency and its various parts. Politicians now demand that agencies and public servants consider the longer-term implications of programmes and policies even if this involves them in 'political' matters. As Joyce argues, 'the recent rise of strategic management and its specific character within the public sector is a sign that public sector management has been

placed under pressure by the political system to adopt a more proactive relationship to change' (Joyce, 2000, p. 214). Political leaders favour this and it is really part of a general realization that the old separation of policy from administration is untenable. It is now common for agencies themselves to develop objectives and priorities rather than assuming policy only derives from politicians.

Without strategy an organization lacks direction. Day-to-day activities do not add up to any coherent goal. Ideally, all activities undertaken help to further specified objectives and beyond them the overall purpose of the agency. As Nutt and Backoff (1992, p. 55) argue: 'Strategy is used to create focus, consistency, and purpose for an organization by producing plans, ploys, patterns, positions, and perspectives that guide strategic action.' As will be seen, there are some problems in applying strategic concepts to the public sector and criticisms of their use. However, in the final analysis, this was a problem area under the traditional model of administration and there is at least the promise of improvement as the result of adopting some form of strategic perspective.

Strategy in the private sector

'Strategy' is a term deriving from the military; it refers to the objective of winning the war, as opposed to 'tactics' – the lower-level objective of winning a particular battle. An analogy between warfare and business was made as long ago as Socrates who compared the duties of a general and a businessman 'and showed that both utilise plans to use resources to meet objectives' (Montanari, Daneke and Bracker, 1989, p. 303). More recent usage derives from Chandler (1962) 'the first to offer an explanation of the evolution of the enterprises in terms of strategy' (Forster and Browne, 1996, p. 22). Applications of strategy in the private sector are obvious enough, with considerable advantages resulting from looking at the long term and the external environment, rather than always considering more immediate internal problems. Normal management processes may be adequate for ordinary operations but it is also necessary, from time to time to, reassess the fundamental reason why the organization exists, what it is trying to do and where it is going.

Even given the intrinsic attraction of strategic concepts in the private sector, it is really only in the immediate post-war period when they begin to be applied in a coherent way. Hax and Majluf (1984, 1996) argue there are five stages in the evolution of planning: budgeting and financial control; long-range planning; business strategic planning; corporate strategic planning and strategic management. These defined stages are relevant to the present discussion because of the difference between strategic *planning* and strategic *management* and, later, for the complementarity of these stages in the private sector with the development of planning in the public sector.

Budgeting and financial control are rather limited forms of planning. Relying on immediate financial results can lead to a rather near-sighted approach to management. Long-range planning, which began in the 1950s,

is an improvement in that it includes multi-year projections of future sales. This made some sense in the immediate post-war period with 'high market growth, fairly predictable trends, firms with essentially a single dominant business, and relatively low degree of rivalry among competitors' (Hax and Majluf, 1984, p. 11), but is limited if these conditions are not met. Long-range planning does not work if there is change in the external environment or strong competition, as the projections are not likely to be met.

There are three forms of strategic planning identified by Hax and Majluf and these have some points in common. All identify an organizational mission, perform some environmental scan, specify a set of objectives and produce a strategic plan to achieve these objectives.

The first kind of strategic planning is business strategic planning. This began in the 1960s, and is where the concepts of mission and environmental scan or analysis first appear. These can be explained briefly.

The *mission* of the business includes a clear definition of current and expected business scope, products, markets and expectation over a period of a few years. The mission involves consideration of what business the organization is in.

The *environmental scan* involves the detailed assessment of the organization's internal strengths, weaknesses, opportunities and threats. This would include items inside the organization: the skills of workers, managerial capabilities, type of plant, financial structures, the constraints of government and the like. However, the real advance is the undertaking of a dispassionate analysis of the external environment, including: market structures and trends, including other countries; the extent of technological change; threats from similar products or substitution; the capabilities of competitors; anything which affects the very existence of the organization.

Objectives are more specific aims resulting from the mission and environmental scan. Elements of strategy at a higher managerial level become objectives at a lower one, as Ansoff argues (1988, p. 54):

Objectives are a management tool with many potential uses. In the operating problem they can be used for establishing performance standards and objectives for all organizational levels, for appraisal of performance, and for control decisions. In the administrative problem they can be used to diagnose deficiencies in the organizational structure. In our main area of interest, the strategic problem, objectives are used as yardsticks for decisions on changes, deletions, and additions to the firm's product-market posture.

From the mission, environmental scan, and specified objectives, a business strategy plan is derived for both the short and longer term, combined with resource allocation and performance measures.

The second form of strategic planning is corporate strategic planning. This emerged in the 1970s due to 'increased international competition, changing societal values, military and political uncertainties, discriminating buyers, and economic slowdown' (Toft, 1989, p. 6). Corporate strategic planning is more

concerned with the higher levels of the organization than business strategic planning and in allocating responsibility even among differing parts of the business. The strategic plan is specified in much more detail than in the first form of strategic planning.

Both business and corporate strategic planning have their limitations. Ansoff argues that early experience with strategic planning 'encountered three serious problems: "paralysis by analysis", that is, when plans produced little result; "organizational resistance" to the introduction of strategic planning, and ejection of strategic planning if the support of top management was withdrawn or relaxed' (1988, p. 166). The problems led to the third form of strategic planning: strategic management.

In the 1980s, strategic planning started to be replaced by 'strategic management', a more refined form that incorporates the strategic planning function, but extends it much further. The difference between them is that 'strategic planning is focused on making optimal strategy decisions, while strategic management is focused on producing strategic results: new markets, new products and/or new technologies' (Ansoff, 1988, p. 235). Strategic management, therefore, is more comprehensive; rather than merely drawing up a plan it aims at integrating planning with all the other parts of the organization. Hax and Majluf argue (1996, p. 419) that:

Strategic management is a way of conducting the firm that has as an ultimate objective the development of corporate values, managerial capabilities, organizational responsibilities, and administrative systems that link strategic and operational decision making, at all hierarchical levels, and across all businesses and functional lines of authority in a firm. Institutions that have reached this stage of management development have eliminated the conflicts between long-term development and short-term profitability. Strategies and operations are not in conflict with one another, but they are inherently coupled in the definition of the managerial tasks at each level in the organization. This form of conducting a firm is deeply anchored in managerial style, beliefs, values, ethics, and accepted forms of behaviour in the organization, which makes strategic thinking congruent with the organizational culture.

Strategic management aims to extend the strategic vision throughout all units of organization, encompassing every administrative system. Instead of being mechanistic, it 'recognises the central role played by individuals and groups and the influence of corporate culture' (Toft, 1989, pp. 6-7). Also, prior to the mission statement, there should be a permanent vision of the firm articulated by the Chief Executive Officer. This corporate philosophy 'has to provide a unifying theme and a vital challenge to all organizational units, communicate a sense of achievable ideals, serve as a source of inspiration for confronting daily activities, and become a contagious, motivating, and guiding force congruent with the corporate ethic and values' (Hax and Majluf, 1996, p. 255).

There are two main points in this. First, there needs to be greater integration between planning, management control and the organizational structure; greater integration between the communication and information system; and

with the motivational and reward systems (Hax and Majluf, 1984, pp. 76-7). Planning should not be regarded as a separate activity, relying on a separate planning department, but as a responsibility of management and not to be isolated from the organization. Secondly, the organization needs to pay attention to its 'culture'. Plans still exist in strategic management, but more attention is paid to implementation because of the human factors present in the organizational culture and affecting its management.

It is easy to see that strategic management fits the private sector and, if implemented well, would provide a company with an information base to make decisions that would not necessarily arise from normal operations. It can help an organization to step back from the normal management process or the day-to-day and ask fundamental questions about the existence and future of the organization.

Strategy in the public sector

Public organizations do have long-term existences and problems in deciding focus. They could conceivably benefit from a strategic approach, although some modification of the private sector perspective may be necessary. There was always some kind of planning in the public sector and the methods used have fairly closely followed the five stages of planning set out earlier for the private sector. Budgeting and financial control started very early in the public sector. This planning stage could be argued to be the quintessence of organizations in the traditional model of administration, where the main planning aim is simply to spend the budget allocation. Long-range planning was also used in the same way as in the private sector and with the same problems of forecasting. Strategic planning in the public sector is a phenomenon of the early 1980s, significantly later than its development in the private sector. Strategic management was also adopted but, again, followed the private sector with a gap of some years. Since 1993 the United States federal government has established strategic planning as a universal requirement for its agencies (Joyce, 2000).

However, strategic planning and strategic management are private sector concepts and it cannot be taken for granted that the ideas will work in the public sector. There are more problems and constraints compared to the private sector and these 'range from constitutional arrangements to legislative and judicial mandates, to government-wide rules and regulations, to jurisdictional boundaries, to scarce resources, to political climate factors, to client and constituent interests' (McCaffery, 1989, p. 207). Nutt and Backoff argue that strategic managers in the public sector 'should be wary of using private sector approaches that assume clear goals, profit or economic purposes, unlimited authority to act, secret development, limited responsibility for actions, and oversight through market mechanisms that signal financial results' and in public organizations 'many of these assumptions are not valid' (1992, p. 23). Early formulations of strategy in the public sector tended to commit all these sins, but

the more recent movement towards *strategic management* may prove the most promising approach, as it has in the private sector.

Bozeman and Straussman argue there are three major features of a strategic approach: defining goals and objectives, developing an action plan that mediates between the organization and the environment, and designing effective methods of implementation (1990, p. 54). According to Allison, strategy involves establishing objectives and priorities for the organization (on the basis of forecasts of the external environment and the organization's capacities) and also devising operational plans to achieve these objectives.

Strategic planning models

In the same way as the private sector, the earliest stages of a strategic approach in the public sector were aimed at *planning* rather than *management*. A useful definition is that of Olsen and Eadie (1982, p. 4) in which 'strategic planning is a disciplined effort to produce fundamental decisions shaping the nature and direction of governmental activities, within constitutional bounds'. This definition stresses three points. First, strategic decisions are 'fundamental decisions', not low-level ones, as the latter can presumably be performed by normal bureaucratic means. Secondly, strategic decisions are specified as decisions which affect 'the nature and direction of activities' and the whole future of the organization. Thirdly, there are limits to the scope of strategic planning of a political and constitutional kind, which is an immediate difference from the private sector. Ideally, strategic planning does not subvert normal political or bureaucratic approaches but takes place within them.

In the early 1980s, Olsen and Eadie were among the pioneers who argued that strategic planning had a place in the public sector, which could learn much from the private sector about planning. They claim that strategic planning process consists of the following basic components (1982, p. 19):

- The overall mission and goals statements, which are formulated by an organization's executive management and provide the framework within which strategies are developed – the 'targets' toward which strategies are aimed.
- The environmental scan or analysis, consisting of the identification and assessment of current and anticipated external factors and conditions that must be taken into account when formulating the organization's strategies.
- The internal profile and resource audit, which catalogues and evaluates the strengths and weaknesses of the organization in terms of a variety of factors that must be taken into consideration in strategic planning.
- The formulation, evaluation, and selection of strategies.
- The implementation and control of the strategic plan.

There are rather obvious similarities with strategic planning in the private sector in this model. When compared to the private sector models set out

earlier, it would seem to have most in common with the business strategic planning model.

The model set out by Osborne and Gaebler is similar, although it does seem closer to the corporate strategy model than that of business strategy. To them 'strategic planning is the process of examining an organization's or community's current situation and future trajectory, setting goals, developing a strategy to achieve those goals, and measuring the results' and most variants involve a number of basic steps (Osborne and Gaebler, 1992, p. 233):

- *analysis* of the situation, both internal and external;
- *diagnosis*, or identification of the key issues facing the organization;
- definition of the organization's fundamental *mission*;
- articulation of the organization's basic *goals*;
- creation of a *vision*: what success looks like;
- development of a *strategy* to realise the vision and goals;
- development of a *timetable* for that strategy;
- measurement and evaluation of *results*.

Osborne and Gaebler draw on the model of Bryson (1988) quite explicitly, so some more detail of that can be spelt out.

The Bryson model of strategic planning

Bryson (1988) puts forward an eight-step model, one that owes a great deal to the private sector model shown earlier. Although there could be some quibble as to the sequence of particular points, it does provide a suitable list of points to enable a strategic plan to be formulated. He sees the steps as follows:

- initiating and agreeing on a strategic planning process;
- identifying organization mandates;
- clarifying organization mission and values;
- assessing the external environment (opportunities and threats);
- assessing the internal environment (strengths and weaknesses);
- identifying the strategic issues facing an organization;
- formulating strategies to manage the issues; and
- establishing an effective organization vision for the future.

The Bryson model is a strategic planning model derived from the private sector, but with some variations to allow for the public sector context.

The first step is the obvious one of initiating and agreeing on a strategic planning process. The second step is to consider the organization mandate, or what is specified in the establishing legislation of the public organization. This is one major difference from the private sector and, no doubt the reason for Bryson

including it as a separate item on the list. In the private sector the mandate is in a sense without limit, in that it is quite common for a company with expertise in one area, say steel, to diversify into the oil or food businesses. This is not the case in the public sector. Public organizations have *mandates*, specified in legislation, that limit the scope of their activity. Mandates are of fundamental importance in deciding on the strategic plan. It is often a useful lesson for public agencies to re-examine what they are meant to do under the legislation which set them up.

The third step is to settle the organization mission, that is, the *raison d'être* of the organization; why it exists at all, and what it is trying to achieve. Public sector organizations find it notoriously difficult to decide exactly what they do. Often this goal uncertainty may have been deliberate, as although vague goals cannot be achieved, neither can anyone say they were not. This is one reason why governments now often insist that strategic plans be prepared. The lack of clarity of goals has become a major weakness in an age in which clear goals are demanded by governments, although the inherent difficulty of goal setting is complicated by the input from politicians. Missions or goals should be specified and analysed, as the very way they are characterized can have implications for how the organization acts. It is obviously not easy for many government agencies to decide what their mission actually is. For example, what is the precise aim of a social welfare department or a health department? Where strategic planning can assist is in making an organization or an agency specify what it is trying to achieve. In many cases this is something not done previously. Organization objectives are at a lower level and should derive from the strategic plan. If the mission is to improve the community's health, then the objectives can be more specific targets in particular areas. As far as possible, although controversial in its implementation, such targets should be empirical.

Fourthly, consideration of the external environment involves essentially the same process as in the private sector. General economic, social and political conditions, the three strategic dimensions of global, social and technological change and the 'negotiated relationship among the various organizations in an environment – determine the level of complexity and uncertainty an organization confronts' (Methé and Perry, 1989, p. 42). Public organizations exist in an environment that has both opportunities and threats. Public organizations in the administrative model were criticized for being overly insular, preoccupied with internal matters and not thinking about how or where their organization exists within government or society as a whole. A good strategic plan would discuss the opportunity or threats faced by the organization in the context of its external environment. The environmental scan should look at both the threats to continued organizational existence and to opportunities in other related areas. Public organizations exist in an environment in which threats are ever-present. A good plan would point to these and do so in detail. It should go beyond the obvious to be a clear, comprehensive picture of where the organization fits in its broader environment.

A public organization is essentially no different from one in the private sector when it comes to assessing its external environment, or in having a need to do so. There are differences of emphasis as Nutt and Backoff argue (1992, p. 180):

The emphasis in the content of SWOTs varies markedly across sectors. First, firms have tight markets and weak political linkages. The reverse is true for public and third sector organizations; markets are loosely defined and authority systems impose constraints ... Second, firms are pulled toward opportunities and public and third sector organizations tend to be driven by threats.

This is a perceptive comment. Public organizations may be more reactive than pro-active and respond more to threats, which means an expectation of a differing result from strategic processes.

Fifthly, the internal operations of the organization are also critical to its existence. If it has internal weaknesses it becomes harder to justify its continued operation in an atmosphere in which any excuse is used for making cuts. The internal environment assessment requires a thorough assessment of the capability of staff. This would include the quality and qualifications of staff, age, sex or other profiles in the hierarchy, departure rates, and less quantifiable measures including the state of morale. There should be an assessment of the extent of resources, particularly financial, but also the systems that are used, notably information systems, accounting systems and so on.

Despite any good plan requiring thorough organizational self-examination, it is usually difficult for an organization to look at itself in a critical way, as this can be construed as a direct criticism of the current leadership. Being able to do so is necessary for a meaningful strategic plan. Any of these internal factors may impinge on the organization's ability to fulfil its strategic mission and objectives, and so must be examined closely.

Sixthly, strategic issues should surface as a result of the environmental scanning activity. This would deal with any weaknesses identified inside the organization, threats from outside, or opportunities for the future. It may be possible to offer new services or new approaches to service delivery. Strategic issues should be separated from day-to-day ones in some way and need to be listed as they would form the basis of strategies to be formulated and implemented. An example of a strategic issue could be a major staffing problem, say, in a tax office where senior, experienced accounting staff are leaving for the private sector at far higher salaries. Another might be that a particular good or service being provided is now being contracted out to the private sector in some other jurisdiction, so that privatization might be considered in future. A strategic issue is a major issue, one that affects the organization's future or ability to function.

Seventhly, formulating strategies – sometimes referred to as deriving an 'action plan' or 'action programme' (Hax and Majluf, 1996) – is where the strategic issues deriving from the previous steps are put into effect. In this step strategies 'are formulated to achieve the selected targets' and, in practice, they

may be considered 'as implementation plans, setting forth the major steps, accountabilities, deadlines, and resource requirements involved in achieving the target' (Eadie, 1983, p. 448). Once strategic issues are identified, an action plan should be formulated to deal with them. In the above examples of strategic issues, a response to the first would be to offer more money or better conditions for the accountants to stay. If an organization feels its existence is threatened by forms of privatization, it would need to be pre-emptive, to make a case for its continuance, and as well to think of contingencies – other alternatives for the staff – if the worst happened.

Eighthly, organizational vision, Bryson's final point, is rather more vague than the mission, but is meant to provide a code, a vision, a shared view of those within the organization for the future. Bryson is not, however, really clear how this differs from the mission. One parallel may be the development in the United Kingdom where public, and formerly public, organizations publish 'citizen's charters' to govern their relationship with clients. Presumably, part of the idea is to provide a shared vision to those inside the organization to govern their behaviour.

In sum, strategic planning, as set out by Bryson, does offer much to the public sector. He argues that 'at its best, strategic planning requires broad-scale information gathering, an exploration of alternatives, and an emphasis on the future implications of present decisions'. It can 'facilitate communication and participation, accommodate divergent interests and values, and foster orderly decision making and successful implementation' (Bryson, 1988, p. 5). It should be regarded as an adjunct to the political process, one with limits. These limits may be greater than in the private sector, a factor which changes the way plans are drawn up and what they contain, but does not diminish the value of the process.

Strategic planning does have limitations in the public sector, in precisely the same way as it did in the private sector. Frequently the only product of the process in the early years of strategic planning in the public sector was to produce a formal document. This documentation was 'all too often the main, if not the sole product' (Eadie, 1989, p. 170). There may be paralysis by analysis, and so on. However, it is markedly better than planning by budget or simple forecasting. More recently, however, there have been moves towards strategic *management*, a more comprehensive approach again deriving from the private sector (see Elcock, 1996).

Strategic management

As noted before, the next stage in the evolution of planning in the private sector is that of strategic management, argued to be a more realistic approach than strategic planning. The public sector, too, is moving towards strategic management as a result of similar limitations found with strategic planning.

Strategic management aims to integrate the planning function with the overall management task. Beyond this point, there are differing views as to exactly what is entailed in strategic management. As in the private sector, strategic planning involves analysing the environment for opportunities or threats, and formulating strategic plans to exploit those opportunities or cope with threats. In one view, strategic management includes these two aspects of strategic planning and extends strategy development to include strategy implementation and strategic control (Montanari, Daneke and Bracker, 1989, p. 305). McCaffery agrees, arguing that strategic management includes strategic planning, but it is 'a more inclusive concept, emphasizing dynamic interaction with the environment and an incremental methodology that allows for scanning the environment to choose the target that will yield the most benefit for the effort expended' (1989, p. 194).

Bozeman and Straussman see four aspects to strategic management. They argue (1990, pp. 29-30):

As we use the term, strategic management is guided by four principles: (1) concern with the long term, (2) integration of goals and objectives into a coherent hierarchy, (3) recognition that strategic management and planning are not self-implementing, and most important, (4) an external perspective emphasizing not adapting to the environment but anticipating and shaping of environmental change. Strategic *public* management adds an additional ingredient: strategic thinking must be cognisant of the exercise of political authority.

The first two are essentially no different from strategic planning. However, the need for good implementation and the greater interaction with the environment are persistent themes in the transition to strategic management.

Eadie argues strategic management includes: an action orientation; recognizes the importance of design; and recognizes the importance of the human factor. An action orientation is to make sure that any document has built-in processes of implementation, including detailed action plans, schedules, accountabilities and specified costs. Design involves 'matching desired outcomes with the processes to achieve them' so that 'what an organization accomplishes through the strategic management process and how quickly these accomplishments are to be achieved are obviously tied to its capability, including human and financial resources' (Eadie, 1989, p. 171).

From these various perspectives, the changes from planning to management seem to be, first, greater care in developing the plan and what it represents and, secondly, greater attention to implementation.

The strategic management plan

Strategic management includes strategic planning and a plan is formulated in a similar way as before. What the plan means and its details do differ from

strategic planning models. One particularly useful model is that of Nutt and Backoff who set out six points for a strategic management plan (1992, p. 152):

- depict the organization's historical context in terms of trends in its environment, its overall direction, and its normative ideals;
- assess the immediate situation in terms of current strengths and weaknesses and future opportunities and threats;
- develop an agenda of current strategic issues to be managed;
- design strategic options to manage priority issues;
- assess the strategic options in terms of stakeholders affected and resources required; and
- implement priority strategies by mobilizing resources and managing stakeholders.

Nutt and Backoff's first point is novel. The strategic management group is asked to 'reconstruct aspects of the history of the organization that have special significance'. In this, 'trends, events, and directions are examined, noting how they have changed in the past and may change in the future' (1992, p. 169). Organizations have a history and a culture, both of which need to be considered in formulating strategy.

The second, third and fourth points are similar to those found in a strategic planning model. The environmental scan is presumed to be more thorough, but this is a difference of emphasis, not kind. Strategic issues and options are similar to before, but the real difference is in recognition of stakeholders and using them to implement strategy.

Implementation

Implementation refers both to the implementation of strategic management and the implementation of any strategic plan once it has been developed. Both of these will inevitably involve changes within the organization. Implementation may be more difficult in the public sector as 'publicness brings with it constraints, political influence, authority limits, scrutiny, and ubiquitous ownership' (Nutt and Backoff, 1992, p. 201).

The biggest implementation problem will be in convincing staff that a strategic focus is useful, and that the changes to follow will be beneficial in the long run. It should be possible for the plan itself to anticipate opposition, and to involve people from all levels of the organization. Organizations contain people who have their own culture, and convincing people or changing cultures are processes that need to be managed and not assumed. Strategic planning models tended to focus on the steps involved without any consideration that there were people involved. The human factor is important (Eadie, 1989, p. 171):

People, as we now know, are as, if not more, important to the success of strategic planning than are the mechanics of the planning process... Since people learn to identify

issues and formulate strategies, considerable attention is now being given to the development of the human resources as a key element in strategic management applications. Also, recognizing the benefits of collective effort in both strategy formulation and implementation, we now properly view management team building as crucial to strategic management success.

The process cannot simply be imposed; there must be ownership of the plan. Stakeholders need to be managed. One key change from strategic planning to strategic management is the importance attached to stakeholders. This is different from 'the narrower concept of strategic planning; stakeholders are decision makers within the organization and its environment who have an interest in organizational performance and can help or hinder the choice and implementation of strategies' (McCaffery, 1989, p. 195).

There are some simple points in improving the management process. It is usually argued that having a separate planning branch to carry out the task is not the best way of formulating any strategy, as other parts of the organization feel no ownership of it. It is better to have a strategic management team of five to ten managers, including the chief executive, but also including managers from levels below top management who are closer to operations (Bozeman and Straussman, 1990, p. 47; McCaffery, 1989, p. 196). Nutt and Backoff also refer to the strategic management group in an organization as made up of 'people who represent interests and power centres internal and external to the organization' and which becomes the 'key source of ideas about change and how to make the change within the organization' (1992, p. 152). The chief executive should be part of this group.

One reason it is hard to introduce strategic planning into public organizations is that many have been static in operation and, more importantly, thought processes, for a long time. To change into a dynamic organization – one with expectations of change – requires a complete change of culture.

The main aim of strategic management is to incorporate strategic thinking into management at all stages, instead of undertaking a one-off planning exercise to produce a document that may not be used. This is much harder, so much so that full strategic management is uncommon in the private sector, let alone the public sector. As Toft argues: 'strategic planning is more widely used in the public sector than strategic management', and this is something that 'probably reflects an earlier stage the business sector has passed through' (Toft, 1989, p. 6). However, it does seem likely that the public sector will eventually adopt strategic management rather than strategic planning and gain some benefits from doing so.

Criticisms

There have been criticisms of bringing strategic planning into the public sector. One set of criticisms applies to strategic planning or management in general, the

other to their application to a public sector context. Olsen and Eadie refer to three categories of reservation and criticism (1982, p. 66):

- The formal strategic planning process is presented as more logical and analytical than it really is or can be. The design is too abstract and fails to take into account the socio-political dynamics at work in any human organization.
- The formal strategic planning process is too rigid and slow-moving to respond adequately to a rapidly changing, turbulent environment.
- The formal process works against creativity and innovation.

Olsen and Eadie then discount these reservations. However, the implementation of strategic planning or management has not been without its problems, suggesting that these or other criticisms should be looked at anew.

Olsen and Eadie's first point has some substance in that there are obvious difficulties in deciding what given public agencies do. To decide mission and goals is rarely easy and may not be meaningful. However, politicians or central agencies increasingly demand plans with clear goals and objectives as part of budgetary decision-making. In the longer term, it will become more difficult for agencies without clear goals to survive in the competition with other agencies for resources. The second point has more validity in that strategic management has been forced on agencies in a rather rigid way in some instances. Also, a plan set in stone for many years will certainly fail as the environment changes around it. This problem should be able to be resolved by good implementation and updating of the plan at regular intervals or by seeing strategic planning as a continuous, rather than cyclical, process. In a time of rapid change, 'environmental scanning and strategy formulation must be ongoing activities if an organization is to respond effectively to both threats and opportunities' (Eadie, 1983, p. 449). Also, the plan itself should not be the main product, but rather the process of thinking about the organization in a strategic way. On the third point, in some circumstances there could be bias against creativity and innovation, although the strategic planning process should itself be innovative and creative. In fact, this might give an opportunity for innovation compared to a static model of administration that did not plan for the future.

There are other criticisms than those noted by Olsen and Eadie. A fourth criticism is of the application of strategic concepts to the very different public sector context. Strategic management has been successful enough in the private sector to suggest that it is a model of some power and considerable validity, but there still may be problems in applying it to the public sector. There may be problems of goals, in that the public sector finds it hard to set goals or objectives for its activities. Olsen and Eadie are themselves criticized as being overly optimistic that a strategic imperative will prevail, with a danger that any plan 'will become a symbolic or ornamental enterprise conscientiously undertaken, but with only slight impact on practical management' (Montanari, Daneke and Bracker, 1989, p. 314). This is a real problem, particularly if the output of the

process is only a document, rather than the process causing a real change in management practices.

A fifth area of criticism refers to problems of accountability. There may be real problems with political control in that, if the strategy is made by the organization this usurps the input of the politician, causing problems of accountability. This criticism suggests that planning is or should be anti-political, when 'it is an integral part of the political process' (*ibid.*, 1989, p. 314). There should not be a problem with accountability with regards to strategy. It is really that the previous rather *ad hoc* strategy is being replaced by more thought and analysis. Strategic planning and management do not replace political decision-making, but rather seek 'to improve on the rawest forms of political decision-making, however, by assuring that issues are raised and resolved in ways that benefit the organization and its key stakeholders' (Bryson, 1988, p. 70).

A sixth possible criticism refers to the difficulties of setting objectives. It could be argued that the objectives of public sector organizations are so imprecise as to make any strategy meaningless. There are two responses to this. First, the imprecision of objective setting may not be as different from the private sector as would normally be imagined. According to Ansoff (1988, p. 28) objectives are currently 'one of the most controversial issues of business ethics' with some writers seeking to 'remove profit from its position as the central motive in business and replace it with doctrines such as equal responsibility to stockholders, long-term survival, or a negotiated consensus among various participants in the firm'. This is some distance from the normal assumption that the private sector is purely motivated by profit. If the objectives of a firm are in reality 'a negotiated consensus of objectives of the influential participants' (*ibid.*, 1988, p. 31), this is not really different from a stakeholder perspective in the public sector.

A second response might be that of Nutt and Backoff who substitute 'ideals' for objectives. They argue (1992, p. 177):

Our strategic management process uses ideals in place of goals. Goals are not used because they are typically ambiguous in public organizations and tend to remain so after clarification attempts... However, leaving goals implicit makes it difficult to modify or even evaluate current practices. Without some concept of the organization's aims, all change becomes contentious and the organization's strategy tends to stay rooted in past practices and conventional wisdom. To provide targets that identify intentions, we use the notion of ideals. Ideals suggest aims that can be articulated in concrete terms to capture goal-like targets and offer ways to seek compromise among competing views that dictate what the organization is (or is not) about.

In this way the strategic management process can go ahead without becoming bogged down in setting precise targets. There must still be ideals of some kind and these should be enough to make the strategy meaningful.

A seventh criticism is that the public sector has such short time horizons that any long-term perspective is bound to fail.

Time perspective is a problem, but rather than this point dooming any strategic plan, it should be factored into the analysis for the plan. Any long-term view in a rapidly changing area does need to be constantly updated. Some private sector industries also change very quickly – computers, for example – but strategic management is still feasible there.

There are other problems. Sufficient information may not be available to enable a plan to be developed. There may be a bias towards measurable activities in the strategic plan, to the possible cost of activities that are not. Staff may be inadequately trained and there is always the problem that even when produced, the strategic plan gathers dust on a shelf and is not regarded as meaningful by the staff.

However, none of these criticisms is so damaging as to make a strategic perspective in the public sector useless. They may serve as a caution against expecting too much and point to the need for careful implementation with stakeholders. It should be a method of thinking above all else, as Bryson argues (1988, p. 46):

Any strategic planning process is worthwhile only if it helps key decision makers to *think* and *act* strategically. Strategic planning is not an end in itself, but merely a set of concepts to help leaders make important decisions and take important actions. Indeed, if any strategic planning process gets in the way of strategic thinking and acting, the process should be scrapped not the thinking and acting.

Introducing a strategic perspective into the public sector is valuable if it is done sensibly, not too rigidly, involving stakeholders, and as an aid to management rather than being an end in itself. It is the case that the transition 'from bureaucratic organizations to strategy-led organizations that manage continuous improvement and responsiveness to the public will take some time to achieve' (Joyce, 2000, p. 229). After this is done, or even while it is managing the process, there should be positive effects on the organization with regard to focus and results and ultimately its long term future.

Conclusion

An enhanced concern with strategy is part of the change from the traditional model of administration to the managerial model. As a result of managerial reforms, no organization can automatically assume its future existence is guaranteed. Even if it may not face the immediate threat of going out of business if a product does not sell, as in the private sector, the difference between sectors may no longer be that great. There is the constant threat of re-organization, amalgamation with some other agency, privatization or the government deciding that the function is no longer needed. The absence of certainty is not altogether bad, as it concentrates attention on what the organization does in terms of goals and missions and in phrasing these to meet the government's overall

strategic objectives. In theory, it should be possible to link the strategic planning process with the other elements of the managerial programme. From the strategic planning process, it should be possible to identify the areas of operation to be concentrated on. These are identified as programmes, funded separately as programmes, and performance measures and detailed evaluations feed back into the strategic planning process the next time around.

In the private sector, strategic management and planning are useful tools for management, although they have not proved a panacea. The same should be true in the public sector. Just thinking about the future is a useful exercise for public sector organizations, although it was neglected under the traditional model of administration. If the aims of strategic planning are to assist in the provision of information, it should prove useful. There have been some bad examples of strategic planning in the public sector, where this lesson was not absorbed. Strategic management should not be introduced in an overly rigid fashion, nor indeed should the managerial system in general. The process should include compromise, political constraints and politicking as an integral part rather than something that occurs outside the model.

Strategic planning or management is not something to be done just once. It is the planning *process* not the plan itself which is important; the use of strategic concepts allow the organization from top management down to develop a shared vision for the future. It does not guarantee that mistakes will not be made. Strategic planning and strategic management simply give some direction and purpose to public organizations, something that is required in moving from public administration to public management.

8

Personnel and Performance Management

Introduction

Although the main focus of public sector reforms has been on the external environment of the public organization, through both strategic management and improving the relationship with outside groups and other external influences, there have been major changes to internal management as well. Public policy and public management may still take place in offices, organized and staffed more or less bureaucratically, so in that sense there is some continuity with the earlier model. Despite this essential continuity with the old model, despite the changes being of detail, there has been more controversy over internal management changes than either strategy or external management. This may be because the traditional model focused on the organization, and, over time, elaborate procedures and systems were built up and changes to them are naturally resisted. There has also been resistance from public servants and public sector unions who find changes to personnel systems – performance appraisal, short-term contracts, merit pay – threatening to long-established terms and conditions of work.

Two main aspects of internal management will be looked at here: personnel management and performance management; financial management will be discussed in the next chapter. All have seen major changes under the managerial model which attempt to make the organization and its internal management systems achieve results rather more directly than before. Even though the greater external focus in new public management is an overdue reform, it only directly involves managers at the higher, strategic levels. The various reforms to internal management, however, have affected everybody within the organization.

All these functions existed to various degrees in the traditional model of administration. There was always attention paid to organizational structures, the personnel management system and the monitoring of performance, although these were considered in a rather narrow, bureaucratic way. Monitoring performance was particularly weak in the traditional model, and

Most of the problems have concerned implementation. It is not easy to institute a new personnel system or to persuade staff that it is better than the previous one. Changes have been so frequent that many staff do not know where they stand. This causes problems of morale, exacerbated by the feeling that a public service career is less attractive. If once it was a permanent career, valued by the community, it certainly is no longer. The implementation of performance indicators is similarly difficult. They should be simple, parsimonious but still meaningful. In theory, all these changes make much sense, but have been difficult to bring into effect.

There are two points to be made in looking further ahead. First, even if there have been problems in setting up new systems, the direction of reform in internal management is quite clear. So if particular changes are difficult they will be superseded by further changes in the same direction, rather than going back. Secondly, comparisons or studies should not look at how well the reforms work in the abstract, but rather how well they compare with what went before. In this regard, all the changes mentioned here are far better than those that existed under the traditional model of administration. In that model, personnel and performance management did exist but were of such dubious quality that any change at all should prove to be a significant improvement.

9

Financial Management

Introduction

Financial management is, arguably, the most important part of the internal management of government. Any activity of government needs money in order to operate; indeed the ability to raise taxation and to spend it is what sets the institution of government apart from other parts of society. Raising and spending money are not narrow, technical operations for any government. The use of money determines the very nature and extent of government activity, as well as the winners and losers in the political competition for financial favours. A party or group in government has access to the government's taxation revenues to spend; a loser has nothing. With the increasing pressures on government both to provide services and to contain or reduce its costs, the budgetary process has become a crucial battleground, one which exists within the bureaucracy no less than in the community at large. A reality of government is the internal political game played by agencies as advocates and moderators of political demands.

Financial management in the traditional model of administration was rather primitive. Due to poor information a form of incremental management was all that could be followed. This was related to inputs into the administrative process as governments had only inferior ways of determining what the public sector actually produced. The information available from input or line-item budgeting was so poor that many of the other features of the traditional model of administration followed. It was thought too difficult to measure performance, if indeed this had been considered. The purpose of an agency in many instances was to spend the budget with little thought as to why or for whom.

Reforms to financial management have been one of the keys to overall public management reform. After more than fifteen years of these, it is possible to assess those aspects of the public management reforms that have worked and others that have not. In the countries that implemented them well, the financial reforms probably worked best. Financial management is now closely related to personnel or performance management, under an umbrella of financial management or a broader strategy like the Financial Management Initiative (FMI) in the United Kingdom in 1982, or the Financial Management Improvement Programme (FMIP) in Australia (see Zifcak, 1994). In turn, the most important

part of financial management, the centre of activity for the bureaucracy, is the government budget.

The government budget

Finance is the centrepiece of government; it is to government what oil is to the transport industry. Without it very little can be done. Budgets have several functions, ranging from the simple recording of government financial transactions to a major role in determining the health of the entire economy. In the simplistic, 'most literal sense, a budget is a document, containing words and figures, which proposes expenditures for certain items and purposes' (Wildavsky, 1979, p. 1). However, any budget is much more than this, as Wildavsky continues (p. 2):

In the most general definition budgeting is concerned with the translation of financial resources into human purposes. A budget, therefore, may be characterized as a series of goals with price tags attached. Since funds are limited and have to be divided in one way or another, the budget becomes a mechanism for making choices among alternative expenditures.

By allocating money for some purposes rather than others, the government may alter the shape of the society. As demands for government spending are always far greater than its capacity to pay, there must be some way of deciding who will be favoured and who will not. There may be technical ways of deciding where to locate, say, a new hospital, but there is no technical way of choosing between a hospital and a school, or between a school and a road. Governments somehow reconcile funding between quite diverse and competing political demands. At the highest level of government, the only way of deciding who is to be favoured by spending, or penalized by particular forms of taxing, is through the imperfect, sometimes irrational, method of political bargaining. Therefore, the budget must ultimately be a political document and procedures must allow for this fact, which means there must be limitations to rationality in financial management systems.

Economic functions of the budget

There are two main functions for the government budget in an overall sense: economic, and financial (Musgrave and Musgrave, 1989). Economic functions concern how the government, through the budget, influences the entire economy. A government tries to achieve a great deal with its overall financial management, so that what inevitably results is a rather unsatisfactory compromise between conflicting aims. This also puts a great deal of pressure on the bureaucracy in devising a financial information system that can provide adequate information in a form which is useful for these various purposes.

Through the budget government tries to determine the level of public activity in the economy, a reasonable distribution of income and wealth, and to provide some control over the overall level of economic activity. These are usually described as policies for allocation, distribution and stabilization.

Allocation Allocation policy is concerned with the relative size of the public and private sectors. In other words, the budget sets out both the overall level of government activity and specifies which activities are to be carried out publicly rather than privately. Both government expenditure and taxation policies influence the allocation and distribution of resources in the private sector. For example, a decision to raise public expenditure on road construction will have widespread effects on the private sector by directing benefits to contractors, concrete manufacturers and their employees.

Arguments about the size of government are really about the system of allocation. The view that government spending and taxing consume too high a proportion of economic activity, suggests there may be a distribution between sectors which is better than the present one. When a government controls a large proportion of economic activity, shifts in its spending have a substantial effect on the private economy. However, allocational decisions cannot be made precisely. There is really no *a priori* or explicitly rational level of government spending and taxing that all citizens accept as fair and reasonable. All a government can do is intuitively compare the electoral costs of imposing particular levels of taxation, with the electoral benefits of expenditure.

Distribution Distribution policy represents the government's attempt to redress to some degree the inequalities in wealth and income between citizens. The major part of distribution policy is the provision of social welfare, including transfer payments to certain classes of citizens, but all other budgetary decisions have some distributional consequences. A tax benefit given to a particular group, such as farmers, is distributional in exactly the same way as are direct payments for social security. As with allocational decisions, the level of transfer payments and the effects on particular groups cannot be determined technically. Musgrave and Musgrave (1989, p. 10) argue: 'the answer to the question of fair distribution involves considerations of social philosophy and value judgment'. Some on the Right even argue that a fairer distribution necessarily leads to a poorer economy by reducing profitability and investment. In practice, as there is no agreement on what a desirable distribution between sectors or income groups should be, arguments about 'fairness' in distribution are inherently controversial.

Stabilization Stabilization policy is where the government aims to improve the overall economy through budgetary policy. This is probably the most difficult economic function. All government spending and taxing decisions have marked effects on the private sector as well, so by varying these policies and

their aggregate levels, an attempt can be made indirectly to influence the entire economy. With the advent of Keynesian economics, governments explicitly accepted responsibility for promoting full employment, price stability, economic growth and a stable balance of payments.

Fiscal policy is important for providing stability for the economy. Although spending and taxing have economic effects of their own, the net balance between them – the deficit or surplus – is of major importance. Keynesian economic theory argues that if the budget is in deficit – expenditure greater than revenue – the overall effects are multiplied so that the whole economy can be stimulated. If the economy is overheated, then the government can, in theory, budget for a surplus to slow the economy. The budget balance can also have effects on the net debt position of the government, and can cause reactions in the private sector, especially in financial markets.

However, from the 1970s there was a change in the intellectual respectability of the Keynesian model. Relying on the government budget to manage the economy originally represented an economic revolution in that budgets did not have to be balanced every year. By varying its budget balance a government could, in theory, ameliorate the damaging affects of the boom and bust business cycle. The Keynesian model promised much and was successful for some time, but the coincidence of high inflation and high unemployment in the mid-1970s produced a reassessment. The orthodoxy is now that of 'neoclassicism', with the emphasis placed on reducing government, balancing the budget and letting market forces find a desirable economic equilibrium.

Financial functions of the budget

The financial functions of the budget are analogous to accounting. Balance sheets need to be drawn up for the whole of government activity, in the same way as in the private sector. The financial functions of the budget are: first, an evaluation of total government and public authority expenditures within the budget sector; and, secondly, to act as the legislature's instrument of accountability and control over the government in its handling of financial matters. The first of these is a pure accounting function to set out estimates of receipts and expenditures. The second is an important part of the system of accountability.

In the earliest days of the English Parliament the financial role was the most important role of the legislature, and one that continues today. Magna Carta was concerned in part with financial matters, with the Crown agreeing to consult the nobles when taxation was contemplated. A long struggle between the Crown and Parliament gradually led to the latter's approval being necessary when taxation was raised, and spending of it was in turn reported back to Parliament. Even now, budget day is traditionally the most important day of the parliamentary calendar. Other countries, particularly those with a British heritage, have a similar financial reliance on the legislature. A United States

President must obtain Congressional approval for spending and has a limited veto over Congressional spending.

The budget is where the accounts of the government are reconciled, and where revenue and expenditure items are set out for public scrutiny. The main steps in budgeting are: formulation – where the budget is drawn up; authorization – the formal approval by the legislature; execution – where it is carried out; and appraisal – how it performed. The budget involves legislation; any government spending or taxation measures must be firmly based in law.

There are significant differences between countries: in the United Kingdom and other parliamentary countries the government is firmly in control of its financial resources; it can dominate all four stages, with almost total control of the first three. This is not so in the United States. The greater degree of separation of the powers – legislature, executive and judiciary – means that, while the President can propose a budget, the Congress is not obliged to accept any part of it. Congress can also pass its own budget measures, something unknown in Westminster systems, where, by convention, the government initiates spending measures. The long period of very large United States government budget deficits during the 1980s and 1990s – something damaging both to its own economy and to the world economy – was in large part due to the government not being able to control its budget, and a breakdown in the system of compromises between Congress and the White House. The entire Federal government sometimes closes down for several weeks, such as in 1996, when no agreement was reached on the budget and, as civil servants cannot be paid without authorization from Congress, they could not work.

Traditional financial management

The traditional model of administration had its own form of financial management, one aptly suited to an administrative view of government. The usual form of financial management was the traditional budget, also called the *line-item* or *input* budget. This kind is for one year: it includes only inputs into the administrative process, and the amounts allocated in a given budget would usually represent incremental changes from the expenditure approved for the year before.

There are several main features of the traditional budget. First, money is allocated to those particular items or types of expenditure that are the major inputs to the task of administration. These typically include money for staff, equipment, postage and all incidental items used in running the department. Secondly, the budget contains a comparison between income and expenditure for the previous financial year. Thirdly, there is a marked tendency for the budget for the forthcoming financial year to be based solely on the record of the previous one. This is *incremental* budgeting; that is, the budget represents a series of incremental increases on the previous year, usually to account for inflation.

The line-item budget does have some points in its favour. It is a good *control* mechanism, although it is difficult to transfer spending between items, and managers have little flexibility. As Wilenski (1982, pp. 168-9) pointed out, the traditional budget is:

First, an ideal mechanism to limit expenditure to the amounts and to the items voted in the appropriations. Secondly, it provides a certain degree of flexibility if across-the-board cuts have to be made mid-year for macro-economic purposes. Third, the traditional budget makes budgeting easier and more manageable: arguing from a historical base is easier than having to justify each item from scratch; choice is routinised, conflict about objectives and methods of achieving them, which might otherwise reach unmanageable proportions, is strictly limited so that the budget is in fact prepared in time. Finally, supporters of the traditional budget claim that it is adaptable to all economic circumstances and conditions.

The system is highly conducive to a meticulous form of financial supervision, in that it can be easily seen whether money was spent on the items for which it was voted. Also, the system fits in well with an annual budget cycle, where agencies are asked to compare their actual expenditure with the amount allocated, and thence to make estimates as to what those items and additional ones will cost in the forthcoming year. Across-the-board cuts can be made and there is even some advantage to incremental budgeting, in that the funding for next year starts with a base in the current year, reducing arguments to the major changes only. However, the advantages of line-item budgeting are insufficient to outweigh its faults. The smallest amount of government expenditure may be accounted for in the traditional budget, but by itself, this kind of retrospective control does nothing to improve managerial efficiency. Managers may be too concerned with demonstrating that they have spent the money 'correctly', or have spent exactly the monies allocated, irrespective of whether their expenditure was either efficient or achieved its purposes.

There are several problems with line-item budgeting. First, it is not clear from budget figures what departments or agencies actually do, or whether they do it well; that is, it stresses *inputs* rather than *outputs*. There is no necessary relationship between input costs and the achievement of any goals as these two are quite unrelated in any documentation. Secondly, line-item budgeting is quite short term, usually only one year in duration. This means that items of long-term budgeting tend to continue unchanged and are not considered in any detail. Instead of spending being decided on a basis of assessed need, it tends to be carried out incrementally, with inadequate critical appraisal. With such a short-term view of the budget there is often no idea of the future cost of new programmes to a second, third or even tenth year. Thirdly, the specific items of expenditure within a budget are quite rigid in that managers have little flexibility in moving resources from one kind of spending to another. If amounts are allocated to particular inputs they are invariably spent, otherwise the budget for the next year may be reduced. Departments might employ extra staff, or spend

money on items that are unnecessary, just to use up the allocation. Finally, the paucity of information in the traditional budget means that politicians have only limited ability to make major changes, and only limited data linking costs to achievements. Politicians or the public have no satisfactory way of judging whether taxpayers' money is serving desired ends, or is doing so efficiently or effectively. As a result of these various flaws, recent years have seen substantial changes to the system of financial control.

Financial management and the public sector reforms

The traditional budget makes no express link between allocation of money and performance. As this is its main failing, it seems an obvious reform to somehow link the budget with outputs and performance. The deficiencies of the line-item budget led to demands for better forms of budgeting, mainly by governments arguing that the traditional method of budgeting did not provide enough information for decision-making purposes.

The early years of financial reform were not encouraging. As far back as the Hoover Commission in the United States (1949), performance budgeting was advocated for the military. It failed there, as did other attempts in the 1950s. The comprehensive 'planning, programming, budgeting' (PPB) system was introduced into the US Defense Department in 1961 and extended to other federal agencies by President Johnson in 1965. The initiative did not survive the Nixon administration and, by 1971, 'PPB as a major budget system and even as an acronym was allowed to die a quiet death' with the main reasons for its failure being (Lee and Johnson, 1989, p. 84):

The lack of the leadership's understanding of and commitment to using programme budgeting tended to deter success, as did an agency's general 'underdevelopment' in the use of analytic techniques. Agencies administering 'soft' social programmes had difficulty devising useful programme measures. Bureaucratic infighting also reduced the chances of successful implementation.

The demise of PPB is sometimes used as an argument against any comprehensive financial management system.

Another attempt at more rational budgeting was that of 'Zero-based budgeting' (ZBB) which was introduced by the United States Department of Agriculture in 1962. The basic idea is that no assumption should be made that future spending is related to past spending, so that the department or agency must justify *all* its budget each year. On becoming President in 1977, Jimmy Carter mandated ZBB for all federal agencies. In fact, ZBB was never applied as expected as a comprehensive management approach. It did not revolutionize budgeting approaches and was abandoned by the Reagan administration in 1981. The main reasons for its failure were the waste of administrative time in producing massive amounts of documentation to justify the total budget and the practical political problems of cutting programmes.

More recent public management changes have included a series of changes to government finance, which are, collectively, far more than was attempted in earlier financial reforms. Guthrie, Olson and Humphrey argue (1997, p. 256):

There have been at least nine categories of 'new public financial management' reforms. The first two categories include changes in financial processing and cash management systems; and improvements in FM information systems. The third category is the establishment of new financial regulations for the authorization and recording of expenditure (including a reliance on professionally set accounting standards). The fifth relates to the promotion of commercially minded asset management systems (with emphasis on contracting out, internal charges, and recognition of depreciation). The sixth are attempts to institutionalize accrual-based accounting information in budgetary, management, and external reporting processes (and the related aspect of the promotion of charging systems for public services). The seventh category is the development of a performance measurement approach within the public sector, including techniques such as financial and non-financial performance indicators, league tables, and programme evaluations. The eighth accounting element concerns the budgetary processes, not only delegated budgets, but also the attempted integration of financial accounting into traditionally economic-based budget information sets. FM [financial management] reforms have especially tried to link budgets (as predetermined plans) with the reporting of results (in financial and non-financial terms). The final category of reforms involves changes to internal and external public sector audits, notably in terms of providing reviews of the efficiency, value for money, and effectiveness of public services.

This is a very comprehensive set of changes. Some of these overlap with other reforms and are not just financial reforms. The main reforms will be considered separately.

Budgeting reforms

The move away from the traditional budget accelerated as governments attempt to regain control of their spending, although as the OECD argued (1990, p. 7):

Unlike the earlier Programme Planning and Budgeting (PPB)-type systems which concentrated on policy planning and analysis of programmes, the current reforms are management oriented and focus on what organizations do and produce and on the means for holding them accountable for performance. More broadly, these developments aim to give managers budgetary and other incentives that make them aware of and accountable for costs and performance, and more willing and able to shift resources from less to more productive activities.

Programme budgeting aims to direct funding more towards the achievement of actual policy objectives or outputs. Under programme budgeting, government activities are divided into the hierarchical structure of programme, sub-programme, activity and component (if necessary). Appropriations can then be made to particular programmes according to the priorities of the government of the day. Instead of funding *inputs* to the administrative process as in the traditional

budget (salaries, overtime, postage and so on), identifiable *programmes* are funded. Management reporting systems can then be based on the programme structure to encourage better feedback on programme performance, and allow, in principle, for evaluating the effectiveness of managers and staff. This, or the extension of programme budgeting to funding outcomes, depends on the establishment of suitable performance indicators. The proper development of objectives, programme structures and performance indicators is a difficult and time-consuming task for all levels in an organization, but is a logical extension of the change from administration to management in government.

There are several advantages in the programme budgeting approach over the traditional, line-item approach. First, it allows better allocation of resources. The political leadership can to some extent reassert its control over budgeting. Under the old system, there was insufficient knowledge of what was actually achieved, as the allocation of financial resources was not related to the work done or to any particular goal. Agencies could squirrel away money for a rainy day without the knowledge of political decision-makers mainly because of the absence of adequate information. Budget choices should be able to be made more explicitly by politicians in terms of national objectives. Secondly, forward planning is enhanced. Programme costs can be extrapolated for some years ahead, which can enable a clearer appreciation of the ongoing cost of pursuing government objectives. Under a one-year system, it may be tempting to undertake new expenditure for political reasons, without worrying too much about longer-term costs. Thirdly, better management practices can be expected, arising from the comparisons of objectives with achievements, not only financial, but other measures of performance which go with them. Finally, budgets are public documents in which the government accounts for the money advanced to them by taxpayers. Presenting information in programme statements which link programme objectives and performance with resources used can improve the link between government and the public. This should also assist in improving the accountability of the government in general and the public services in particular.

There has been a shift from detailed regulations and compliance management to 'increased use of the discretion and initiative of operational managers in achieving targets' with policies in place to wind back 'centrally-held controls over inputs, delegating spending authority, providing greater flexibility to line ministries and agencies, and developing a range of incentives for improved performance' (OECD, 1990b, p. 6). Common reforms include provision for savings realized to remain with spending agencies and not be automatically re-appropriated by the central budget office. There is more financial discretion left with operational managers. These advantages are substantial, so much so it is a wonder line-item budgets remain anywhere. However, it is salutary to remember that the PPB system failed in the United States in the 1960s.

Another important budgeting change involves the preparation of detailed budget estimates beyond the usual single year. This is another generally

successful reform. In Australia, for example, Forward Estimates have been prepared since 1972, but since 1983, their format has been greatly improved and published in time to assist the following year's budgetary process. Forward Estimates provide the government and the public with information on the level and composition of spending over the next three years and with quite comprehensive forecasts of spending and revenue beyond that. Rather than comprising 'wish lists' from departments, they now represent an assessment of government spending, both overall and on particular programmes, that will occur in the absence of policy changes. This enables the long-term costs of programmes to be better estimated.

Accounting reforms

Traditional budgeting is based on cash, that is, revenue received and outlays paid out and in the one year. Accrual accounting is more sophisticated as it includes the value of assets in a more comprehensive way. Its major objective is to compare the total of economic costs incurred during a reporting period against the total economic benefit accrued in that period. In other words, the value of assets is included as well as their depreciation, so that a complete picture of the government's financial position is known in a way similar to that of the private sector. This system has the advantage of the full position being known and to provide a more meaningful comparison of financial inputs to policy outcomes.

Accrual accounting was implemented as early as 1991 in New Zealand, but it was only during the late 1990s that other jurisdictions tried it. In Australia the federal government started in 1999–2000 as did the state governments at around the same time (Carlin and Guthrie, 2001). Such accounting reforms are 'an important part of the process of transforming spenders into managers'; a manager needs to be accountable for costs (OECD, 1997, p. 25). An OECD paper argues there are conditions for it to work (1997, p. 25):

Two conditions must prevail for accrual accounting to be more than a bookkeeping exercise: managers must have genuine choice in deciding whether to bear the costs; and the costs they are charged must have an impact on the financial resources available to them ... The second condition is that costs affect the resources available to the agency. If an agency were charged for depreciation, this cost should reduce the resources otherwise available for operations.

Accrual accounting requires that the full costs be charged to operating units, including accommodation and assets used, in other words, the full economic cost of operating that unit.

In principle, accrual accounting would by itself drive substantial reform. However, accrual accounting, or what Carlin and Guthrie term 'accrual output-based budgeting' (AOBB) is difficult to bring about and, if implemented badly,

could impose similar rigidity as the traditional model. It does, however, offer an improved accounting system to go along with other parts of public management.

Another aspect of accounting is the more intense use of auditing than was previously the case. Public sector auditing once concentrated on financial probity by managers rather than whether or not a programme or agency was serving any useful function. Performance auditing can address this. It is part way between financial management and performance management. It covers the auditing functions carried out by auditors, usually independent from the areas being reviewed, but its role includes deciding whether programmes themselves were effective as well as looking for financial probity.

Devolution of budgets

Related to the previous point, governments have increasingly devolved budget authority to line managers. Instead of the allocation of photocopiers, for example, being decided centrally, it becomes the decision of a line manager to decide if that section wishes to buy a photocopier or a computer or use it for some completely unrelated purpose. In principle, a one-line budget could be given to a particular manager to then manage the resources as he or she chose. The idea is to relate budget authority with management authority. As Thompson argues (1997, p. 6):

In the private sector, operating budgets are primarily a means of motivating managers to serve the policies and purposes of the organization to which they belong. Budgets convert an organization's commitments into terms that correspond to the sphere of responsibility of administrative units and their managers and provide a basis for monitoring operations, evaluating performance, and rewarding managers.

The same principle can be applied to government. A manager needs to produce results and the budget is the main resource allowing this to be done. This has generally worked quite well. As an OECD paper argues (1997, p. 23):

Entrusting managers with responsibility for their operating resources has not compromised spending control. It has proven easier to maintain cash limits when managers are given a fixed budget within which to operate, than when spending details are controlled by outsiders. Managers have demonstrated that they can maintain timely and accurate financial records and that they can compile financial statements that comply with accounting standards.

In principle, devolution of real budget authority to managers is inarguable: in practice it has not been so easy for central agencies to devolve budget authority as completely as might be desirable.

Contracting out

The contracting out of the provision of government services can, in some senses, be considered a financial reform. It is assumed that cost savings will be

made, usually seen as of the order of 20 per cent (OECD, 1998). It is perhaps more important that contracting is an extension of programme budgeting and specifying what is required in performance terms. In drawing up a contract it is necessary to spell out exactly what is to be achieved and the mechanisms of monitoring. The detailed delivery is then in the hands of outsiders, but in principle there is little difference in what could occur within government, by specifying exactly what an agency or a section is to achieve and funding it accordingly. If the mechanisms are precise enough, there should be no great difference in internal or external provision, other than not having public servants carrying out the delivery.

In general, the financial reforms aim to make the public sector more like the private sector in terms of how it deals with money. As Kamarck argues (2000, pp. 246–7):

Performance-based budgeting, the use of new accounting systems, and the general interest in accountability exhibited by some of these reform movements are part and parcel of an effort to bring the public sector's financial management more in line with commonly accepted practices in the private sector. Like civil service reform, many of the experiments in financial management reform seek to close the gap between the public and the private sector.

It could be argued that the private sector is hardly a model, given the lack of agreement over accounting standards and the like. However, it is still more rigorous than the public sector was under the traditional model of financial management. Financial management is concerned most of all with providing information to enable decisions to be made. The newer forms of management do this better than did the previous one.

Criticisms of financial reforms

Despite a fairly general view that the financial reforms have been successful there have been criticisms of specific elements.

Budget reform criticisms

Instead of budgeting through inputs, the newer management looks at using outputs or performance, particularly programme budgeting. This has attracted criticisms since the 1960s and the PPB system in the United States.

The most prominent critic of programme budgeting was Wildavsky. For him, programme budgeting has failed 'everywhere and at all times' (1979, p. 198). His general argument is that programme budgeting is an attempt to impose rationality on what is basically an irrational (or highly political) process. Yet his criticisms may not be as universal as he suggests. They greatly overstate what programme budgeting can actually do, because, as pointed out earlier,

the final budget decisions are necessarily political, in that choices must be made between totally dissimilar activities. Programme budgeting, at least as it is now being implemented, simply provides far more *information* for the politicians who finally make the decisions. At the point of decision, their choices may still be irrational, although more information obviously helps decision-making. Also, Wildavsky's criticism of PPB is likely to be far more applicable to the United States – where budgetary responsibility is diffuse or evaded altogether – than in parliamentary systems where the executive has complete control over its budget. Results in parliamentary countries point to more success than might be suggested by American experience in the 1960s and 1970s. Programme budgeting requires considerably more information about the activities of the agencies than is required for traditional line-item budgeting, so is not easy to implement. But even if there are difficulties in its implementation, programme budgeting offers far better information on which to base budgetary decisions.

Another problem is that of the political environment. Gray *et al.* (1991, p. 52) studied the implementation of the FMI initiative in the United Kingdom and found some disillusionment with its implementation, which 'reflects the way public sector organizations are both administrative *and* political entities':

By imposing rules of budgeting and financial reporting, for example, new accounting systems change the balance of interest and advantage within the management of government and, as a consequence, expose latent political tensions. This problem was recognized by the FMI designers; the intention was indeed to change the behaviour of financial management by changing the rules which governed it. Civil servants are traditionally adept at playing and adapting to games; it is a feature of their socialization both before and after entering the service. But, the balance of advantage in resource allocation has shifted in favour of those who can exploit the very marked emphasis on economic rationality expressed in the FMI rules and systems.

In principle, the budget becomes more rational but in practice there may be a façade of reform, behind which is the old form of incrementalism.

Traditional budgeting was usually considered to be an incremental activity, characterized by small increases from the budget of the previous year to account for inflation, and with some theorists (Wildavsky, 1979) arguing that this was beneficial. There have been substantial changes to the system of budgeting, but does this really mean the end of incrementalism? Complete rationality in budgeting would require listing all alternative ways in which money could be spent, enumerating the advantages and disadvantages of each, and then selecting the highest ranking preferences and funding them accordingly. No government could conceivably do this, for two reasons. First, budgeting in a democracy is, and must be, a political rather than a technical process, which means that a complete, technical system like PPB will probably fail. Secondly, budgeting is necessarily composed of commitments, such as social security entitlements which cannot be rapidly changed. The amount of ongoing commitment in any budget is variously estimated at around 90 or 95 per cent of total

spending. Accordingly, any policy change is likely to involve small shifts, characteristic of incrementalism.

In practice, the performance-based budget may be more limited than it appears. Performance in the past and prospective performance are only one influence on budget making. As an OECD paper argues (1997, p. 24):

In theory, the budget should be one of the principal means by which performance measures affect public policy. It should not be difficult to devise a performance-based budget system in which each increment of resources is directly linked to a planned increment in output... Yet the governments examined... have not closely linked performance and budgeted resources, preferring instead an arrangement in which data on actual or expected results is just one of several influences on the budget.

While far from the ideal, a budget process that is not completely mechanistic is more realistic. Incremental budgeting could be considered, above all, a response to inadequate information, so that, if better information is provided, choices can be made in an other than incremental fashion. Other influences will make their way into the process, but in the end a budget is an inherently political process.

A traditional budget gave a minor role to the politicians. It denied them adequate information to make decisions and provided no systematic record of the achievement of results. Budget reforms, as with others to the management of the public sector, have improved the position of the political leadership. Budgetary decisions may still be made in a political manner, and for political reasons, but can be more precisely targeted. The traditional budget was also ideal for public servants to conceal possible areas of fat, hoarding these as resources to fall back on in hard times. This could occur in the absence of good information about where money was being directed. With better information, the expenditure control system has been tightened from above.

Problems with the accounting changes

Pollitt and Bouckaert argue that 'the application of accruals systems is not equally straightforward for all different types of service and circumstance, and reform can create perverse incentives as well as advantages' (2000, p. 69). This is undoubtedly the case. Carlin and Guthrie also argue that accrual accounting reforms are 'more than neutral, technical, disinterested activities' (2001, p. 89). They can drive organizations into the managerial direction, into market-based activities and can alter the distribution of power within and between organizations.

The biggest difficulty is that of implementation. Adopting accrual accounting can provide more transparency, better relate outcomes to inputs and the like, but the task of putting a system together is difficult. Due particularly to problems of implementation, it is argued that such systems 'can provide welcome assistance in the effort to improve public management practices' but 'will

not constitute the panacea suggested by some central agency rhetoric' (Carlin and Guthrie, 2001, p. 98). As more jurisdictions use accrual accounting it will become easier to determine the worth of this particular reform, but it is one that takes a lot of work to bring into effect.

Problems with contracting

A requirement to contract out or privatize may end up being more costly than in-house delivery. Private contractors need to add profit margins to the cost of provision, so if all other things are equal, it would cost more. In most circumstances the efficiency gains of private provision might still be present, but this needs to be investigated and not assumed. As Donahue argues, 'Private firms in competitive markets are frequently more efficient than government bureaucracies, but it is romantic to infer from this that the mere fact of private organization, without competition and without market tests, leads to efficiency' (1989, p. 222). The circumstances in which contracting-out will work are spelt out by Donahue (1989, p. 98):

The more precisely a task can be specified in advance, and its performance evaluated after the fact, the more certainly contractors can be made to compete; the more readily disappointing contractors can be replaced (or otherwise penalized); and the more narrowly government cares about ends to the exclusion of means, the stronger the case for employing profit-seekers rather than civil servants. The fundamental distinction, however, is between competitive, output-based relationships and non-competitive, input-based relationships rather than between profit-seekers and civil servants *per se*.

There is considerable promise in privatizing or contracting-out, but the approach needs to be pragmatic rather than ideological.

In theory, private contractors should work more efficiently, but there is an added burden for public managers above those of simply contracting-out. This is to ensure compliance with the terms of the contract to make sure that performance occurs. Compliance is not straightforward, as several questions, both political and technical, need to be worked out. Administrative and technical questions involve such matters as 'drafting the contract, meeting legal requirements for bidding, creating adequate performance specifications, monitoring the contract properly, encouraging competition, and avoiding excessive dependence on contractors' and 'these administrative matters involving how to contract become more important than the basic policy question of whether to contract' (Reh fuss, 1989, p. 219). Contracting-out may reduce the size of the bureaucracy, but ensuring compliance and monitoring contracts is likely to require a public service with higher skills.

Privatization in the contracting-out sense does offer benefits, but only in some circumstances at some times. When it works well there are benefits in privatization. However, when it works badly 'privatization can muddy public finance, make public management more complex and awkward, strip away

vital dimensions of the public purpose that are hard to pin down contractually, transfer money from public workers to contractors without any savings to the collective fisc, allow quality to decay, and *increase costs*' (Donahue, 1989, p. 217). Setting the conditions is not a simple task. However, it should be approached pragmatically rather than ideologically and attention should be given to the important task of monitoring by public servants. Contracting to reduce costs offers promise for the public services, but brings difficulties with it and should not be regarded as a panacea.

There are difficulties with the financial reforms, but this area is generally regarded as one of the most effective of the public sector reforms. This view may derive from the parlous state of financial information provided in traditional budgeting, so that regardless of the problems involved, the financial management reforms seemed so much better than what had gone before.

Conclusion

Government financial management is fundamentally political, but, rather than usurping the political process, the financial reforms will hopefully enhance it by providing more and better information. It is unlikely that the old system of programmes that persisted for many years without examination can survive with financial management reform. Political leaders may still indulge in pork-barrelling or in making wild promises they have no intention of keeping. The new forms of financial management should at least be able to make it clear what the costs will be. Governments with programme information can cut spending on marginal activities and increase spending on deserving activities. The government budget and budget process are now closer to what they should be: tools for management. Overall, the restructuring of public management 'has brought sizeable efficiency gains that are reflected in lower staffing levels and reductions in real operating expenditures' (OECD, 1997, p. 10).

Financial management has been transformed, in some countries, from a traditional system that provided little information and did so in an opaque way, to one where, in theory, precise data can be provided to aid decision-makers. The problem with the traditional budget systems is that there is no information as to either the purposes of the spending or how well or badly the purposes have been met. Wildavsky opposed rationality in budgeting, but times have changed; information systems have been greatly improved; no longer is it sustainable to avoid financial reform because it is hard to do.

All that any financial or accounting system can aim to do is provide information. Performance budgets set out the costs of identifiable programmes, which, along with associated measures, allow for decisions to be made as to whether or not they are achieving their purposes. Accrual accounting allows for the long-term consequences of spending to be calculated more precisely by its effects on the overall balance sheet as it includes changes in asset values.

Of course, financial reforms are not perfect; of course there are problems in precisely setting the performance measures; of course accounting systems can be used to reinforce power structures. They can also be used to hide or deceive as has occurred even in the private sector. But more information allows for better decisions to be made, though it does not guarantee them. In a democratic system those decisions are made, for good or ill, by elected governments, where the traditional financial systems allowed civil servants to hide the true state of the accounts from their supposed masters. Having transparent accounts does increase ministers' power and those of central agencies, but is more accountable to the people. This is clearly better than when there was so little information that the best form of accounting was by cash and the best form of budget was by input only with an amount set aside for salaries, with a little bit allocated to other inputs such as postage and phone calls, and without any requirement for performance. All that any financial system can do is provide information, which can then be used or abused. Old-style, traditional budgeting did not provide sufficient information for choices to be made. And even with new financial systems in place, there is nothing to stop a government from making a bad budgetary decision. It will, however, be made aware of the long-term consequences in a way that was not possible before.