



Office of Hon Murray McCully

Minister of Foreign Affairs

John Allen
Secretary of Foreign Affairs and Trade

Dear John

I have now had the opportunity to consider the Ministry of Foreign Affairs and Trade change proposals and am writing to you, as I indicated I would, to offer formal comment.

At the time that the document was released to staff I stated publicly that the change proposals were a genuine attempt to modernise the Ministry so that it would be equipped to service New Zealand's diplomatic, trade, security and economic interests both today and in the future. As we both know, change is overdue. At the outset I want to place on record my support for you, as chief executive, and your management team, who have carried the burden of introducing change to an organization that has not previously experienced it.

This process takes place against a backdrop of general fiscal pressure in which major departments of state have been requested to make savings. The Treasury/State Services Commission letter to you identified a proposed target of \$24m in savings and I acknowledge that your change proposals are in part an attempt to meet that objective.

Prior to the release of the consultation documents to staff I was forthright in my views about some aspects of the reform proposals. It would be fair to say that the consultation process has seen strong criticism directed at many of those same features of the change process. Now that the obligatory consultation process is coming to a close it is important that key decisions are made quickly, to adopt changes where they will provide long term benefits, and suspend change debate where they will not. This letter is designed to facilitate quick and clear decision making on your part.

To provide context, the comments that I will make in this letter are made in my role as purchaser of services from the Ministry. I want it to be clear that I have no intention of substituting my judgment for your own as chief executive. As we have discussed, the yardstick that I have had to apply to these proposals is different in some respects from that of the Ministry's management. For example, I have tried to give a clearer sense of the strategic priorities that the Government would wish to pursue, as a basis for more significant resource reallocation. On the other hand, I have also had some regard for the management of political risk, given the highly politicized commentary that this process has attracted.

Modernisation

As you know, I questioned the need for a process that would require such large numbers of existing staff to apply for new positions in the Ministry. In the event, I was persuaded that the introduction of the principle of appointment on merit could only be achieved by taking this otherwise unwelcome step. The introduction of appointment on merit, which will give you the opportunity to refresh senior management positions, and the embedding of this principle in the Ministry's culture, will be major steps forward, the significance of which it is hard to over-state.

Having said this, I need to re-state my concern that such a dramatic process should be managed in a way that protects the Ministry's talent base, in which New Zealand taxpayers have made a substantial investment. In that respect I must comment that the management of the proposed remuneration arrangements has been distinctly counter-productive. It is important that the actual costs of carrying out an offshore secondment are fully understood by the Ministry. Equally, it is important that officers with families are able to serve offshore secondments. The bottom line test is that the Ministry leadership has been charged with ensuring that these changes are carried out in a manner that retains the base of talented and experienced diplomatic staff.

International Footprint

While I welcome the proposals to make changes to New Zealand's international footprint as part of the change process, it is my view that we should attempt to reach a closer alignment of Ministry resources with New Zealand's strategic priorities. In that respect I think we have both agreed that it would be appropriate to have a clearer expression of those strategic priorities and for this process to be refreshed on an annual basis.

Given the time constraints associated with this exercise I propose to offer brief commentary based upon the change proposals. We have agreed to supplement this commentary with direct discussions prior to my submitting proposed changes to the Cabinet for consideration.

The twelve European posts currently carry a combined operating budget of \$64m. This reflects the very substantial trade and diplomatic interests that characterise New Zealand's relationships with Europe, and also the rather inflexible manner in which foreign services have operated in past times. It is my view that we should attempt to significantly update our profile. A target of removing \$12m in operating costs (not including seconded CS staff) over the next two years should in my view be achievable, especially in light of the substantial costs of current accommodation arrangements in Paris. In addition to the proposed closure of Stockholm and Warsaw, this would call for consideration of significant downsizing or closure in The Hague, Rome and Madrid. Any such steps would of course require compensatory strengthening of key European posts.

By contrast, I am concerned that the significant ambitions we have for growth in trade and economic ties with China, South East Asia, India and the Middle East (set out in the NZ Inc strategies) could be affected by the proposed reductions of staff in those

markets. It is my view that, while we might wish to configure our resources differently, we should maintain current budget allocations in each of those centres at this time.

As you know, the Government places a high priority on its relationships in the Pacific. However, it is my view that the reintegration of the development role into the Ministry has not been reflected in the staffing of some of our Pacific posts. Looking further ahead, successful transition in the Solomon Islands and in Timor Leste will provide opportunities for further change. I believe further discussion directed towards achieving reintegration benefits in posts will improve resource allocation in each of the next two years.

The change proposals highlight the very significant savings that can be achieved from the withdrawal of seconded corporate services personnel (in excess of \$6m). In principle I support this proposal. However, some regard will need to be given to the practical effect of withdrawing these personnel, and the flow-on impact on diplomatic staff. In posts in which we are expecting a significant lift in trade and economic activity a net reduction of resource would send the wrong signal. While supporting the proposal in principle, I would like to ensure that we except a range of posts for this reason.

Outsourcing

Outsourcing proposals have been advanced as a source of very significant economies, although the proposal to staff is couched in conditional terms. While I appreciate that further work is being undertaken in this area I have voiced my concerns about the risks inherent in this process from the very beginning. Those concerns have now been reflected very strongly in the consultation process, from heads of mission in particular. Even if the proponents of outsourcing had objectively established their case (which in my view they have not) the current negative environment surrounding the concept would render it impossible to successfully implement on a global basis. Further, while industrial relations practices in some European jurisdictions would make outsourcing highly attractive, it is extraordinarily unattractive in some Pacific posts, where we would make redundant significant numbers of modestly paid local staff for no good reason.

Any move to outsourcing would carry significant foreign policy and political management risks. The proponents of outsourcing have advanced no credible plan to manage those risks. Already I am receiving representations from some Pacific nations regarding the impact of the proposal to disengage local staff.

As you know, I have sought further information regarding the capacity to disaggregate outsourcing services, so that we might take some gains without the off-setting risks. In particular we have discussed the prospect of trialling aspects of outsourcing regionally, for example in Europe. I record my appreciation of your acceptance of the Government's concerns over the major outsourcing proposal originally advanced, and acknowledge that you will wish to continue some work in this area where efficiency and effectiveness can be advanced in a lower risk manner.

Back Office Costs

I have made clear my disappointment that MFAT continues to carry back office costs that are seriously excessive. It is a non-negotiable bottom line policy of the Government that back office costs be reduced. It has been asserted to me that the

change programme, and the proposed outsourcing initiatives, require substantial corporate services capacity to be retained in the interim.

I accept that the IT project, which will ultimately permit a substantial reduction in Ministry staff, needs to be carried to completion. However, especially in light of the agreement not to proceed with large scale outsourcing, I wish to see significant efficiencies in the back office.

In the absence of outsourcing the Property function, we urgently need to find a way to improve discipline in this area. I would like to discuss with you a proposal to appoint a small external board to work with yourself as chief executive and myself as Minister to find a more efficient and effective mode of operating the Ministry's property portfolio, especially in light of my previously expressed desire for re-configuration of the portfolio in capitals like Paris.

Heads of Mission

While a strong underlying purpose of the change proposal was to achieve greater efficiency, the practical effect of it was to make staffing decisions for heads of mission in a very directive manner. The effect of the consultation discussions and of the Government's response is to leave considerably more room for local decision-making. We both agree that it would be desirable for heads of mission to carry more responsibility and accountability in this regard. Indeed, the Government's concerns in relation to the outsourcing proposal will mean a high degree of dependence upon heads of mission to ensure that sensible economies are well managed. I see more empowered, accountable heads of mission as one of the more significant advances from the change programme.

Next Steps

Finally can I record my strong desire to see steps now taken quickly to provide certainty for staff, allowing for a rebuilding of confidence, professionalism and morale. I look forward to taking whatever steps I can to contribute to that process. It is my hope that this letter and our ongoing discussions will create an environment in which maximum certainty can be provided to staff at an early time, while allowing for some of the more complex issues to be addressed in a careful fashion, under less pressure of time.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Murray McCully', written over a faint, illegible typed name.

**Hon Murray McCully
Minister of Foreign Affairs**