# THE KIWI EFFECT

## What Britain can learn from New Zealand

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## Bibliographical information

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# Contents

# Executive Summary

Britain can learn much from New Zealand's post-1984 experience about how to reform government to promote vigorous non-inflationary economic growth.

### Comprehensive reform

From the 1930s to 1984, successive Labour and National governments[1] sought to insulate New Zealand from the vicissitudes of the world economy through steep trade barriers, suffocating regulations, heavy subsidies to agriculture and industry, and state ownership of many commercial enterprises. However, massive state intervention yielded disappointing results, as in the UK.

After Labour's victory in the 14 July 1984 election, the government of Prime Minister David Lange launched what the Organization for Economic Co-operation and Development (OECD) called the "most comprehensive economic reform programme undertaken by any OECD country in recent decades."[2] Following National's win in the 27 October 1990 election, the government of Prime Minister Jim Bolger expanded upon Labour's liberalization programme. Both parties grounded reform in the following principles:

1. limiting the state to performing functions that private sector cannot do well;

2. deregulating and fully exposing the domestic economy to international market forces;

3. achieving an operating surplus and reducing government spending and debt as a percent of GDP;

4. maintaining price stability, and

5. increasing the transparency in government decision-making.

### No sacred cows

Every segment of Kiwi society was open to reform; there were no "sacred cows."

But there was a bonfire of controls. New Zealand abolished quantitative restrictions on *imports*, slashed *tariffs*, terminated *agricultural subsidies*, and revoked *foreign exchange and investment restrictions*. Controls on *prices*, *interest rates*, *dividends*, and *wages* were lifted. *Financial services* and other industries were deregulated.

Income tax rates were *halved*, and a value-added tax was introduced.

## Civil service reform

While drawing upon economic liberalization programmes in other countries such as the UK, New Zealand pioneered many state sector reforms. Recognizing that Public Service employees[3] are, by and large, well-meaning people who, responding to perverse bureaucratic incentives, produce inefficient and sometimes undesirable outcomes, New Zealand is the first country to *systematically reform government operations* to attempt to give Public Service employees the same incentives found in private enterprise and thereby improve state sector performance.

New Zealand *unbundled the old Crown Departments*, segregating policy advice, regulatory, service delivery, and commercial trading functions. *Regulatory and service delivery functions* were spun-off into Crown Entities. *Commercial trading functions* were transformed into State-Owned Enterprises (SOEs) and required to operate without the benefits of a monopoly or taxpayer subsidies. Most SOEs were eventually *privatized.* Some movement has been taken in this direction in the UK in the Next Steps programme, but they are much more limited than in New Zealand.

Permanent Secretaries, the senior Public Service officers who administered each Crown Department under the supervision of a Minister, became Chief Executive Officers (CEOs). Ministers now *contract annually with departmental CEOs* for government outputs. To achieve their output goals, *CEOs may freely employ, reward, and* discharge personnel, may *acquire and dispose of assets*, and may *choose other production methods* without bureaucratic interference. CEO compensation is tied to the output performance of their department.

## Sound finances

New Zealand found that cash accounting, still used by the UK government, did not provide the Cabinet or departmental CEOs adequate and timely information to make financial decisions in this new environment. Therefore, New Zealand became the first country to *replace cash accounting with accrual-based Generally Accepted Accounting Practice (GAAP) for government budgeting* and financial reporting.

While Crown restructuring improved the incentives facing Public Service Employees, New Zealand still needed to reform overall fiscal management to end the bias towards short-term political expediency among Ministers and MPs. To help elected politicians focus on long term economic considerations, New Zealand enacted a *model fiscal constitution*, the Fiscal Responsibility Act of 1994. The Act established the principles of *sound fiscal management* and provides for *full disclosure* of relevant economic and fiscal information to prevent "rosy scenario" budgeting, in which governments provide optimistic predictions of economic growth.

New Zealand has enacted a *model monetary constitution*, the Reserve Bank of New Zealand Act 1989. In place of multiple and conflicting objectives, the Act enshrines a single goal for monetary policy, "achieving and maintaining *stability in the general level of prices*."[4] Under the Act, the Minister of Finance and the Reserve Bank Governor must sign a Target Policy Agreement precisely defining price stability. The Act grants the Reserve Bank full autonomy to achieve price stability but also *makes the Governor personally accountable* if the Reserve Bank fails to achieve its objective. In the UK, there is now widespread support for giving the Bank of England much greater independence with a clear mandate of price stability.

## Industrial relations

Finally, New Zealand adopted the world's most advanced labour-management relations law. The Employment Contracts Act 1991 allows employers and employees to bargain for themselves or freely select agents to bargain for them. *Contractual terms* are set by private negotiations except for a few general mandates and prohibitions. The Act *forbids compulsory unionism* and strikes except in cases of contract expiration or an immediate threat to the life, health, or physical safety of employees.

## A laboratory for reform

In the last decade, New Zealand has been the world's laboratory for successful economic liberalization. The 1995 *World Competitiveness Report* ranked New Zealand as the eighth most competitive of 48 major economies and third in the world in the quality of government.[5] As British politicians of all persuasions seek to constrain the size of government and to improve its effectiveness, they should look to the success of New Zealand. That experience should prompt UK policymakers to:

- *reorganize the entire executive*, breaking up large departments with combined policy advice, regulatory, service delivery, and commercial trading functions and locating these functions in separate organizations, taking the ideas in the Next Steps Initiative much further;

- require Secretaries of State to enter into *explicit contracts for government outputs* from the agencies under their direct supervision;

- place members of the Senior Civil Service on *individual performance-based employment contracts*;

- *authorize the ranking officer in each agency* to employ, reward, and discharge personnel, contract for goods and services, and make capital expenditures within their existing asset base;

- *require accrual-based General Accepted Accounting Principles* (GAAP) for UK government accounting and budgeting;

- *apply a capital charge* to the budget of each agency and department;

- grant the Bank of England full independence to conduct monetary policy with the single goal of *price stability*.

# 1 Introduction

In a single decade, New Zealand's economy underwent a thorough transformation. From what had been one of the most highly taxed and tightly regulated economies outside the communist bloc, New Zealand became one of the freest economies in the world, as several authoritative enquiries have confirmed. Thus a panel of leading economists put together by the *Economist* rated New Zealand as *the* freest economy in the world. Another study of 102 countries ranked New Zealand as the third freest economy in the world, behind Hong Kong and Singapore. The 1996 Index of Economic Freedom ranks New Zealand as the fourth freest among the 140 economies surveyed, surpassing all others except Bahrain, Hong Kong, and Singapore.[6] Unlike the other ranked economies in these two studies, New Zealand combines both economic and political freedom, earning the highest ratings for political rights and civil liberties from Freedom House.[7]

This transformation has produced remarkable results. Since 1992, New Zealand has sustained *high rates of economic growth* with real GDP expanding 5.9 percent for the 1994/95 March year,[8] and an estimated 2.6 per cent for the 1995/96 March year, while underlying inflation (CPI excluding mortgage interest rates) has remained under 2 percent.[9] *Private sector investment is booming*, up 26.1 percent for the 1994/95 March year, and an estimated 4.8 percent for the 1995/96 March year.[10] *Unemployment reached a seven-year low* in the September 1995 quarter with an unemployment rate of 6.1 per cent. Moreover, New Zealand has *reduced government expenditures* from 41.2 percent of GDP in 1990/91 fiscal year to 35.1 percent of GDP in 1994/95 fiscal year, and an estimated 35.2 percent of GDP in 1995/96 fiscal year, producing an operating surplus of 3.01 percent of GDP in 1994/95 and an estimated 3.3 percent in 1995/96. Net outstanding *government debt has fallen* from a peak of 51.8 percent of GDP on 30 June 1992, to 37.6 percent of GDP on 30 June 1995 and an estimated 33.4 percent of GDP on 30 June 1996.[11]

This report examines New Zealand's economic transformation, focusing on state sector reforms. New Zealand is the first country systematically to apply the lessons of public choice economics and develop an alternative to the bureaucratic model of delivering government services. Consequently, New Zealand pioneered many reforms in administration, financial management, fiscal policy, labour-management relations, and monetary policy. The Kiwi state sector reforms provide a valuable model for the UK as it seeks to constrain the size of government and improve its effectiveness and efficiency.

## The burden of controls

For five decades prior to 1984, successive Labour and National governments heavily intervened in the New Zealand economy. As former Minister of Finance Roger Douglas noted, these policies "were rapidly turning the New Zealand economy into the most regulated economy outside communist Europe."[12] Not surprisingly, the Organization for Economic Co-operation and Development Economic Survey noted:

> [T]he New Zealand economy was one of the most highly protected in the OECD. It lacked labour force skilling, suffered from rigid factor and product markets and supported high effective tax rates. In addition, the government's persistent tendency to accommodate external shocks resulted in high and variable rates of inflation. In these conditions, investment was often misdirected, and there was little competitive pressure to control costs.[13]

**Insulationism.** The origins of this malaise, so similar to the UK in the 1970s, is not hard to find. During the 1930s, New Zealand embarked upon a great expansion of the state's role in the economy. The government adopted a *policy of insulationism* to try to shelter New Zealanders from the worst affects of the economic downturn. New Zealand raised tariffs and instituted *import licensing* and *foreign exchange controls* to protect domestic industries. New Zealanders were required to seek approval for outward foreign investments, while an Overseas Investment Commission policed inward foreign investments. Except for an abortive attempt to lower tariffs and lift import licensing in the early 1950s, restrictive border measures continued to shelter the domestic economy until the mid-1980s.[14]

**Regulation and subsidy.** Beyond border measures, *strict regulations* distorted Kiwi markets. The financial services industry was highly regulated and segmented into specialised institutions operating under different sets of rules. Regulations permeated economic decision-making, from dictating shopping hours to preventing freight transport companies from hauling goods more than 40 miles in competition with the Crown-owned railway.[15]

Responding to low international commodity prices, New Zealand initiated an *agricultural subsidy programme* in 1935 by guaranteeing the price of milk. By 1984, overall agricultural assistance peaked at 30 percent of total farm income.[16] Pastoral agricultural assistance reached an incredible NZ$1.7 billion in 1983/84 fiscal year, an effective assistance rate of 314 percent.[17]

Insulationism caused a gradual *decay in Kiwi economic competitiveness*. New Zealand used border controls to restrict imports mostly to raw materials and equipment used by domestic manufacturers. Sheltered from competing finished goods, New Zealand business heavily invested to build a diversified manufacturing base. This protection was, however, a siren's call. With a guaranteed market, Kiwi manufacturers had little reason to innovate new products, improve quality, or control costs. Rather than specialize in a few internationally competitive products, Kiwi manufacturers made a little of everything for the domestic market at a very high cost.

**Falling productivity.** Thus, *productivity and income growth rates in New* Zealand fell to the lowest among the developed countries. In 1960, New Zealand had the seventh highest per capita gross domestic product (GDP) in the world.[18] However, from 1960 to 1984, New Zealand's average annual productivity growth rate was a mere 1.2 percent, compared to 5.8 percent in Japan, 3.3 percent in the European Union, and 2.5 percent in the United States.[19] Consequently, Kiwi income growth stagnated. From 1960 to 1984, real GDP per capita increased by an annual average of 1.4 percent in New Zealand compared to 2.7 percent in all OECD countries.[20] By 1984, New Zealand fell to 18th place in per capita GDP.[21] Despite a high level of investment, New Zealand suffered from low economic returns.[22]

**State domination.** Economic deterioration accelerated after the 1973 and 1979 oil price shocks. The Muldoon government responded with a massive program of *taxpayer-financed investments in industrial development projects* known as "Think Big". These projects — New Zealand Steel, New Zealand Petrocorp, New Zealand Synthetic Fuels Corporation, and the Marsden Point Refinery — were economically unviable. By 1986, they had accumulated a debt of NZ$7.2 billion or NZ$2,500 per capita and were publicly derided as "Sink Big."[23]

As a result, *state commercial trading activities dominated many sectors of the New Zealand economy*.[24] By the early 1980s, state commercial trading activities together accounted for about 12 percent of Kiwi GDP and 20 percent gross domestic investment. By fiscal year 1985/86, these activities had consumed NZ$20 billion of investment capital, but failed to achieve any net return for Kiwi taxpayers.[25]

While the private sector spluttered, New Zealand's state sector swelled. *Government expenditures ballooned* from 27.5 percent of GDP in the 1971/72 March year to 40.7 percent of GDP in the 1983/84 March year. Simultaneously, the budget moved from a small fiscal surplus to a deficit of 6.5 percent of GDP.[26]

*Inflation and unemployment soared.* Inflation rose from the 4.1 percent annual average consumer price index (CPI) rate of 1960s to a 17 percent annual CPI rate in June 1982.[27] On the 22nd of that month, the Muldoon government announced a 12-month freeze on all wages, prices, and dividends. The freeze was then extended for first 12 months and then another 8 months. Unemployment skyrocketed from less than 1,000 in the 1960s to 131,700[28] in 1984.[29]

The Muldoon government was intellectually bankrupt and unable to cope with economic crisis confronting New Zealand. By 1984, many National voters were disgusted that their nominally right-of-centre party was led by a Prime Minister who was implementing socialist economic policies.[30]

# 2 Liberalization under Labour, and beyond

In the July 1984 general election, New Zealand voters defeated Muldoon's National Party and elected the Labour government of Prime Minister David Lange with a 56-37-2 majority.[31] While most observers expected some policy changes, few could imagine the sweeping and rapid economic liberalization that was to come under a left-of-centre Labour government. The Labour government remained united behind this liberalization programme throughout its first term and was able to increase its majority to 57-40 in 1987 general election despite the dislocation pain associated with reform.[32]

In 1988, however, the Labour government was divided over how to reduce a large NZ$3.2 billion budget deficit. Prime Minister Lange supported a significant tax boost while Minister of Finance Roger Douglas and a majority of the Cabinet favoured NZ$2 billion in spending reductions. Douglas left the government in late 1988; and Lange resigned in August 1989.[33] The National Party swept a divided Labour Party out of office 67-29-1 in the 27 October 1990 general election.[34]

Remarkably, the new Prime Minister Jim Bolger retained and indeed expanded Labour's economic liberalization program. The Bolger government moved to liberalize the labour market, the one sector of the economy that Labour was unable to reform, and enacted the most advanced labour-management relations legislation in the world. Although New Zealand was just emerging from the world-wide recession, the National government was re-elected in the 1993 general election with a small one-seat majority.

While a complete evaluation of New Zealand's economic liberalization programme is beyond this paper's scope, a brief review of the entire programme follows so that the context in which state sector reform was undertaken may be understood.

### Trade liberalization

- The Labour government began *lowering tariffs* unilaterally soon after taking office. In 1994, the National government announced the third (1997-2000) of a four-phase programme to abolish all tariffs by 2004. New Zealand's average weighted tariff is currently 3.4 percent; 93 percent of all imports are duty-free.[35]

- In 1984, 25 percent of New Zealand's imports were subject to licensing. The Labour government initiated a *phase-out of import licensing* that was completed in 1992. Today, there are no quantitative restrictions on imports to New Zealand.[36]

- New Zealand has negotiated and implemented a comprehensive *free trade agreement with Australia*, the Closer Economic Relations (CER) agreement. New Zealand is strongly committed to creating a free trade and investment area in the Asia-Pacific region by 2020.

### Financial liberalization

- All *wage, price, credit, interest rate, and dividend controls* were abolished during 1984.

- All *foreign exchange transactions and overseas investment controls* were lifted in December 1984.

- The New Zealand dollar was allowed to *float* on foreign exchange markets in March 1995.

- *The financial services industry* was progressively deregulated. Market entry into banking is now open to any financial institution able to provide banking services in a prudent manner. Non-bank financial institutions may compete with banks in providing any banking services.

**Unsubsidized agriculture**

- The Labour government *abolished agricultural subsidies* soon after taking office. Government support for agriculture has fallen from 30 percent of total farm income to less than 3 percent since 1990. Government agricultural spending is now limited to inspection, quarantine, research, and pest control.[37]

**Industrial deregulation**

- The Labour government began to *terminate industry subsidies* and *dismantle internal trade barriers* soon after taking office.

- *Monopoly privileges* on domestic air service, electricity generation, long distance freight hauling, and telecommunication were *abolished* during 1986-87.

- *Restrictions on shop hours* were abolished in August 1990.

**Tax reform**

- The top *personal income tax rate* was slashed from 66 percent to 33 percent in October 1986. New Zealand now has the lowest top personal income tax rates among the OECD countries.[38] The company income tax rate was reduced from 48 percent to a flat 33 percent in October 1986.

- A 10 percent *Goods and Services Tax* (GST) replaced various selective wholesale sales taxes in October 1986. The GST rate was raised to 12.5 percent in July 1989.

- *Estate taxes were abolished* in 1992.

# 3 Principles of state sector reform

## Principles

The Lange government, believing that the bloated state sector had become a dead weight on the New Zealand economy, decided that the state sector should be exposed to the same invigorating market forces which were beginning to transform Kiwi agriculture and industry. State sector reform was based on the following five principles:

1. The state should perform only those functions that *cannot be efficiently or effectively performed by the private sector.*

2. Commercial trading functions within the state sector should be *structured along the lines of private enterprise.*

3. *Departments should be restructured* to separate policy advice, regulatory, service delivery, and commercial trading functions.

4. *Departmental managers should be fully accountable* for the efficient operation of their organizations with a minimum of centralised control on inputs.

5. The costs of state services should as far as practical be determined by *real market factors.*

## Legislation

Under the Lange government, Parliament enacted three major pieces of state sector reform legislation:

- *The State Owned Enterprises Act 1986* provided the basis for converting state commercial trading activities into State-Owned Enterprises (SOEs), businesses owned by the state, but operated as if they were private.

- *The State Sector Act 1988* reformed the Public Service. Permanent Secretaries became Chief Executive Officers (CEOs) employed under individual, limited-term, output-based, performance contracts with their supervising Minister. Public Service protection was lifted from most other departmental employees, granting CEOs broad authority to hire, reward, and fire personnel.

- *The Public Finance Act 1989* transformed state sector financial management and reporting. The Act transferred the responsibility for paying departmental bills, collecting accounts, and managing funds from the Treasury to each department. Accrual-based Generally Accepted Accounting Practice (GAAP) accounting was instituted (see chapter 6). Departmental CEOs were freed to choose what inputs their departments will use to achieve the output goals established in annual negotiations with their supervising Minister.

The Bolger government pushed another major bill reforming the state sector through Parliament:

- *The Fiscal Responsibility Act 1994* increased the transparency and accountability of the government in fiscal policy and established the principles for responsible fiscal management.

# 4 Competition, corporatization, and privatization

In New Zealand, the reform process for state commercial trading activities occurred in three stages:

(1) full exposure of state commercial trading activities to market competition,

(2) conversion into a state-owned enterprise (SOE), and finally

(3) transfer to the private sector in the form of stock flotation, trade sale or management buy-out.[39]

## Competition

In the first stage, the government introduced competition or at least contestability[40] with state commercial trading activities. The government abolished the monopoly privileges that many state commercial trading activities had enjoyed. Then, it established a stable regulatory environment in which state activities and their new competitors would vie. Consistent with its proclivity for deregulation, the government relied upon two general statutes, the Commerce Act 1986,[41] New Zealand's competition law, and the Fair Trading Act 1986,[42] its consumer protection law, rather than establishing industry-specific regulatory regimes.[43]

## Corporatization

The second stage of reform was to reorganize state commercial trading activities along private business lines with instructions to maximize net worth. In April, 1987, seven trading departments were corporatized into nine stand-alone SOEs. Other commercial trading activities have subsequently been corporatized.[44] Under corporatization, state commercial trading activities are converted into a company form with the Ministry of State-Owned Enterprises as the sole shareholder. Richard Prebble, the Minister for State-Owned Enterprises under the Lange government, sought to duplicate the culture and methods of private business as much as possible. Leading Kiwi businessmen were appointed to the SOE boards of directors. In turn, board members hired CEOs who exercised the normal powers of a CEO in a private business. The government was allowed to specify and explicitly pay for social objectives, but otherwise SOEs were to operate as wealth maximizers.[45]

After corporatization, SOEs reported some immediate productivity and profitability gains. For example:

**Postbank.** The New Zealand Post Office Savings Bank was converted into an SOE, Postbank, in April 1987. The former suffered from having too many outlets, overstaffing, outdated information systems, and political interference over its deposit rates and investment decisions. After corporatization, Postbank reduced its staff by 30 percent and outlets by 40 percent. Instead of an expected loss of NZ$50 million in 1987/88, Postbank turned a profit of NZ$30.8.[46]

**Electricity Corporation (ECNZ).** From 1986/1987 to 1990/1991, ECNZ cut staff by 45 percent, increased productivity by 71 percent, slashed costs by 28 percent, reduced average wholesale electricity prices by 13 percent, and lifted after-tax profits 187 percent to NZ$404 million in 1990/91.[47] By 1994/95, ECNZ earned NZ$386 million or 12.5 percent return on equity.

**Forestry Corporation.** From 1986/87 to 1989/90, the Forestry Corporation reduced staff by 65 percent, achieving a NZ$150 million profit in 1989/90.[48]

**Coal Corporation.** State coal mines lost money in 20 of the 22 years prior to corporatization. In the three years after corporatization, productivity rose nearly 60 percent and real prices fell by 20 percent. By 1990/91, Coal Corp earned a small profit of NZ$8.9 million.[49] By 1994/95, Coal Corp earned NZ$17 or 19.3 percent return on equity.

**Telecom Corporation.** In the three years from corporatization in 1987 to privatization in 1990, Telecom cut staffing level by 47 percent, increased productivity by 85 percent (in terms of the number of lines per employee), and boosted profits by 300 percent. The percentage of customers on digital technology rose from 30 percent to 93 percent, directory services were answered within 30 seconds rather than waits of up to 20 minutes, and the waiting time for new service installation fell from six weeks to less than three days.[50]

**New Zealand Post.** In the three years after corporatization, staff levels decreased by 30 percent while the percent of next day delivery rose from 17 percent to 98 percent.[51] For 1994/95, New Zealand Post earned NZ$72 million or 32.4 percent return on equity. Consequently, New Zealand Post announced a reduction in the standard postage rate from 45¢ effective from 2 October 1995. Only Spain and Turkey have lower standard postage rates among OECD countries.

## The need for privatization

Despite initial gains in productivity and profitability, the New Zealand experience reveals seven inherent difficulties in the corporatization model and suggests that SOEs should be privatized if these gains are to be sustained. Of course, these problems also apply to non-corporatized bodies.

First, *politicians may attempt to obscure income transfers to favoured constituencies* by using SOEs. For example, the Housing Corporation has operated under conflicting mandates — to maximize profits and subsidize rental housing for lower-income tenants.

Second, *the energies of SOE management may be unnecessarily diverted into political disputes.* For example, the Telecom CEO contested the size of the dividend that the government required from Telecom in 1990 even though Telecom now pays out similar dividends to its new owners after privatization.[53]

Third, *Ministers may be enticed to appoint board members based on political affiliation* rather than business acumen. For example, the Lange government appointed a former Labour MP to the Railway Corporation board, while the National government appointed former National MPs and party officials to the New Zealand Post, Railways Corporation, and the Housing Corporation boards.[54]

Fourth, *special interests may pressure Ministers to become involved in the day-to-day commercial operations of SOEs.* For example, under consumer pressure, the Bolger government forced the Electricity Corporation to rescind proposed price increases in 1992. While acknowledging that the ECNZ should determine its own prices, the Prime Minister urged ECNZ not to make price decisions that would "defer economic recovery." Moreover, two Ministers told ECNZ that the government would accept a lower rate of return to facilitate a price decrease.[55]

Fifth, *the compensation granted to CEOs at SOEs may become politicized* and hinder SOEs from attracting top-flight management. As in the UK, the press has criticized the high compensation paid to CEOs compared to Ministers and Judges.[56]

Sixth, state ownership creates an impression that *the government will bail out an SOE in financial trouble.* For example, the remaining state equity in the Bank of New Zealand (BNZ) after partial privatization led both Labour and National governments to inject large sums into BNZ after it encountered financial difficulties.[57]

Finally, the state may be *unwilling to provide sufficient risk capital* to sustain the economic competitiveness of an SOE over time. Governments face various demands for taxpayer funds. Ministers are under pressure to meet the immediate needs of their constituents rather than invest risk capital in research and development of new innovative products and services that SOEs need to remain competitive.[58]

Corporatization may mitigate but does not eliminate the deficiencies of state ownership. Indeed, the World Bank has recognized that:

> First, private ownership itself makes a difference. Some state-owned enterprises have been efficient and well-managed for some periods, but government ownership seldom permits sustained good performance over more than a few years. There is a higher probability of efficient performance in private enterprise.[59]

Moreover, Standard & Poor noted that many Kiwis understand that corporatization is only a half-way station to privatization:

> That corporatization can be followed by privatization is a recognition of the limits to performance improvement which may exist under corporatization, given the absence under government ownership of performance incentives provided by the threat of bankruptcy or take-over. The necessary final stage in the process of improving public sector efficiency in New Zealand is therefore seen as privatization. Only in this way might it be possible to realize ultimate efficiency gains and to ensure that benefits achieved by corporatization are not reversed in time.[60]

Many of the agency managers, as in the UK, recognize the limitations of corporatization and want to escape into privatization; while others fear the loss of the civil service lifestyle.

**State-Owned Enterprises**
Remaining as of 22 November 1995

Airways Corporation of New Zealand Limited
Coal Corporation of New Zealand Limited
Contact Energy Limited
Electricity Corporation of New Zealand Limited
Forestry Corporation of New Zealand Limited
Government Property Services Limited
Land Corporation Limited
Meteorological Service of New Zealand Limited
New Zealand Forestry Corporation Limited
New Zealand Post Limited
New Zealand Railways Corporation Limited
The Radio Company
Television New Zealand Limited
Trans Power New Zealand Limited
Timberlands West Coast Limited
Vehicle Testing New Zealand Limited
Works and Development Services Corporation (NZ) Limited

## Privatization

Thus, the third stage of reform was privatization. In New Zealand, the objectives of privatization were to further the substantial efficiency gains from corporatization and reduce the state's financial exposure. Through privatization, the Labour and National governments implemented the first principle of economic reform: limiting the state to performing functions that the private sector cannot do well.

**Comparison to UK.** The goals and methods of New Zealand's privatization programme differed from those in the United Kingdom. First, the government of Margaret Thatcher sought to popularize privatization by spreading share ownership through concessionary share sales to managers, employees, and ordinary customers. This was thought unnecessary in most New Zealand privatization as share ownership was already widespread.[61] In those privatizations such as Air New Zealand or Telecom where the government thought that spreading share ownership was important, the government required a share flotation.[62]

Second, the Thatcher government also used concessionary share sales to blunt ideological opposition to privatization. In contrast, Lange's decision to adopt an anti-nuclear foreign policy and bar U.S. armed forces ships, submarines, and planes was very popular with many Kiwis and led them to mute their opposition to privatization. Essentially, the Lange government used a dovish foreign policy as political cover for economic liberalization.

Third, the Thatcher government sought to maximize the government revenue by selling some monopolies to the private sector. As a result, the British government was forced to establish industry-specific price regulations to prevent the newly privatized firms from exploiting their monopoly.[63] In contrast, New Zealand strived for economic efficiency by ensuring that privatized firms would operate in a competitive environment. Overall, privatization along with other asset sales earned NZ$12.8 billion for the state through 30 June 1995.[64]

**New Zealand privatizations**
To 30 June 1995

Air New Zealand
Bank of New Zealand (BNZ)
Communicate New Zealand
DFC (investment bank)
Export Guarantee Office (loan portfolio sale)
Fletcher Challenge Limited Shares
Forestry Cutting Rights (ongoing asset sales)
GCS Limited government Supply Brokerage
  Corporation (NZ) Limited
government Printing Office
Health Computing Service
Housing Corporation Mortgages
Landcorp Mortgages
National Film Unit
New Zealand Rail Limited
New Zealand Steel
Petrocorp
Petroleum Mining Licenses
Postbank
Rural Banking and Finance Corporation
Shipping Corporation
State Insurance Office
Synfuels
Telecom Corporation
Tourist Hotel Corporation of New Zealand Limited
Wrightsons Rights (share rights sale)

**The Kiwi approach.** Both the World Bank and the International Monetary Fund have applauded the privatization process in New Zealand as a successful model.[65] The process in New Zealand has normally occurred in the following stages:

- The government established the appropriate regulatory environment to facilitate competition and then *corporatized the trading activity to minimize uncertainty* over enterprise value and the future regulatory environment for potential bidders.
- Public servants and their private consultants carefully *examined the enterprise to assess potential value and methods of sale.*
- *Potential bidders around the world were notified* of the availability of an enterprise.
- *Interested bidders were invited to make an initial offer*. A short list of the best initial offers was prepared, and these bidders were invited to make a final, binding offer.

- *Public servants and their private advisers* prepared sale documents, screened bids, monitored due diligence by shortlisted bidders, evaluated the merits of each bid, and made final recommendations to Ministers. To increase transparency and avoid political interference, *Ministers were not involved with the day-to-day management of the sale process* up to this point.

- After recommendations were made to the Cabinet, *Ministers then decided on the recommendations whether and to whom to sell*. Sales were for cash, complete, and clean of any post-sale guarantees or conditions.[66]

Adherence to this process proved essential to the success of privatization given the ideological opposition of some New Zealanders and the complex managerial and regulatory issues involved. Ministers were pressured to abandon the economic efficiency goal in favour of particular bidders or bias sale conditions against foreigners. Nevertheless, Ministers understood that favouring one buyer would ultimately result in a wealth transfer from taxpayers to the favoured buyer and they successfully resisted these political pressures most of the time.[67] Indeed, privatization proved troublesome only in those instances when the government deviated from the established process. For example, ideological pressure caused the Lange government to reject a recommended bid for the Bank of New Zealand from Brierley Investments in December 1988 on the grounds that it was too low. In less than six months, however, the government bailed out BNZ because of its loan losses.[68]

CEOs and directors of privatized companies have a strong commercial orientation. Political considerations no longer affect decisions on strategic direction, board appointments, and management compassion. Like other firms, privatized companies may freely raise risk capital in debt and equity markets, fund research and development, initiate new products, and diversify operations. CEOs and directors are highly motivated both by the opportunity for higher profits and share prices and the spectre of a hostile take-over and bankruptcy.[69]

Consequently, privatization has generated enormous efficiency gains in New Zealand through higher productivity and improved custom focus and product selection. For example:

**Rural Bank.** Since Fletcher Challenge acquired Rural Bank in November 1989, it has applied new technology and improved risk management. The Bank's non-performing loan ratio has declined from 4.1 percent to 1.5 percent. Staffing levels have fallen by 36 percent while operating expenses fell by 19 percent.[70]

**Postbank.** Since ANZ Banking Corporation acquired Postbank in December 1988, Postbank has enjoyed additional gains on top of those accrued in corporatization. Postbank has benefited from ANZ's expertise in product development, marketing, and risk management. Capital expenditures on new technology increased and, costs have fallen due to economies of scale.[71]

**Air New Zealand.** Despite a downturn in the international market since privatization in April 1989, Air New Zealand was able to achieve a 28 percent increase in productivity. Staffing was reduced by 10 percent. As many loss-making domestic routes favoured by politicians were shed, Air New Zealand enjoyed a sharp rise in passenger-revenue kilometres flown.[72] In 1994/95, it earned NZ$260 million or a return on equity of 20.4 percent.

**Telecom Corporation.** Since privatization, Telecom's earnings rose 280 percent and the return on equity climbed from 10.6 percent to 29.7 percent in 1994/95. Average long distance rates declined by 50 percent. Telecom is investing annually on new technology approximately NZ$700 million or about 1 percent of GDP.[73]

**Petrocorp.** Partially privatized in August 1987, Fletcher Challenge acquired the government's remaining 70 percent share in March 1988. Since full privatization, Petrocorp's profits have grown 264 percent. Between 1990 and 1992, unit production costs for urea and methanol decreased by 10 percent and 1 percent, respectively. Oil production is up 135 percent.[74]

### Ongoing corporatization and privatization

The Bolger government recently sold Radio New Zealand Limited (commercial radio stations) after separating and retaining its non-commercial stations. The government has decided that Government Property Services Limited should liquidate its existing portfolio, except for the Bowen House, Bowen State Building, Defence House and the Freyberg Building. The government is currently discussing the privatization of the Forestry Corporation of New Zealand Limited with Maori leaders. To encourage competition in electricity generation, the government has decided to split the Electricity Corporation into two separate SOEs. Although the government has not make any additional commitments, the division would facilitate subsequent privatizations.

# 5 Core governmental functions

Corporatization and privatization are only part of a successful strategy to reform the state sector. Reform must also improve the delivery of core government functions and other services that may remain within the state sector because of political considerations. For more than a century, democracies have used the bureaucratic model for delivering government services. However, the bureaucratic model — with its hierarchical organisation, civil service regulations, and input controls — has become increasingly inefficient. To reduce government spending and improve service delivery, the bureaucratic model must be replaced.

## Public choice in the public service

New Zealand is the first democratic country to develop an alternative to the bureaucratic model based upon the insights of public choice economics.[75] Public choice teaches that people in government, from a President or Prime Minister down to the most junior civil servant, will predictably advance their own interests within the state's institutional framework. Therefore, the institutional framework in which they operate is more important than individual personalities in determining outcomes. New Zealand acknowledged that government is not costly, inefficient, and ineffective because of corrupt politicians or lazy bureaucrats. Instead, it is the *system in which they work* that creates incentives for sloth and waste. To cut costs and improve service quality, New Zealand systematically re-examined the state sector and worked to incorporate the incentives for productivity found in private enterprise into the institutions of the state.

New Zealand is unique in the scope of the institutional reforms that have occurred in the last decade. In 1984, the state employed more than 88,000; today that state employment is down to approximately 36,000. The structure of the state sector has been entirely transformed.[76] *Whole departments were eliminated*; some functions were *corporatized and later privatized* while other functions were *placed in new departments or agencies*. To overcome the inherent bias for higher spending when government employees attempt to evaluate their own department, New Zealand *systematically segregated policy advice, regulatory, and service delivery functions* into different agencies.[77]

## Central agencies

Three of the 44 departments[78] — the Department of the Prime Minister and Cabinet, the Treasury, and the State Services Commission — operate as central agencies that perform head office functions for the government. The Department of the Prime Minister and Cabinet provides the government with constitutional and general policy advice and supports the government in managing its agenda. The Treasury advises the government on economic and fiscal policy, and prepares the Budget. The State Services Commission advises the government on human resource matters, employs and manages departmental CEOs, works with CEOs to manage members the Senior Executive Service, negotiates collective employment contracts on behalf of the CEOs, and enforces Equal Employment Opportunity programmes within the Public Service.[79]

**New Zealand's new model for state administration**

| | Bureaucratic model | New Zealand model |
|---|---|---|
| **Accountability structure** | Input-based controls<br>• 2 "control" departments Treasury and State Services Commission<br>• Number of large "public service" departments combining policy advice, regulatory, service delivery, and commercial trading functions<br>• Plus a few quangos and government-owned corporations | Output-based contracts<br>• 3 "central" agencies — Department of the Prime Minister and Cabinet, the Treasury, and State Services Commission<br>• 44 "line" departments<br>• 2,919 Crown Entities providing either regulatory or service delivery functions<br>• 17 State-Owned Enterprises conducting commercial trading activities |
| **Management** | • Permanent Secretary<br>• Most senior Public Service officers in departments<br>• Compensation unrelated to performance | • Chief Executive Officer (CEO)<br>• Limited-term contract<br>• Compensation tied to output performance |
| **Financial administration** | • Treasury managed receivables and payables for every department | • Each department or Crown Entity manages its own receivables and payables |
| **Accounting** | • Cash accounting | • Accrual accounting (GAAP) |
| **Personnel** | • All personnel were under Public Service protection<br>• State Services Commission hired personnel and fixed compensation | • Public Service protection is limited to departmental CEOs and a few other senior officials<br>• CEOs have authority to hire compensate, and fire other personnel |
| **Production inputs** | • Treasury controlled supply, equipment, and asset purchases | • Centralized controls abolished<br>• Within an asset cap, CEOs may buy, lease, or dispose of equipment and facilities |

### Line departments

There are 41 line departments, among them the Department of Conservation, Ministry of Defence, New Zealand Defence Forces, Ministry of Education, Ministry of Health, New Zealand Police, and Statistics New Zealand. Most are quite small, employing fewer 100 people, with quite sharply defined functions. However, Inland Revenue remains large and continues to perform a mixture of functions.[80]

### Crown Entities

The Public Finance Amendment Act 1992 established Crown Entities, a second tier of administration. Excluding the Reserve Bank of New Zealand, there are 2,919 Crown Entities. Some are regulatory agencies such as the Commerce Commission, the Casino Control Authority, and the Maritime Safety Authority of New Zealand. Others deliver services such as Crown Health Enterprises (23 in number), Museum of New Zealand Te Papa Tongarewa, New Zealand Symphony Orchestra Limited, School Boards of Trustees (2,677 in number), and tertiary education institutions (39 in number). Crown Entities have their own board of directors, who employ a CEO. Crown Entities operate under a "Statement of Intent" negotiated with their supervising Minister and tabled in Parliament. These statements specify objectives, criteria for measuring performance, and accountability provisions.[81]

### Education and health

Two sectors, education and health care, demonstrate how institutional reform changed bureaucratic incentives and improved service delivery. In each case, the government dismantled a large, centralized department that simultaneously provided policy advice, organized the delivery of services to the public, and regulated practitioners. The government *assigned these functions into separate agencies*. New highly focused ministries were established for policy advice functions. *Service delivery units such as schools and hospitals were transformed into autonomous Crown Entities*. Each now has its own board of directors, which choose a CEO, establish policy, and allocate funds. Bulk funding, a type of bloc grant, guarantees these Crown Entities operational autonomy. *Consumer freedom of choice* between service delivery units encourages competition among Crown Entities and promotes cost efficiency and service excellence.

**Education.** Prior to reform, a centralized Ministry of Education advised the government on education policy, operated primary, secondary, and tertiary schools, appointed administrators and staff, selected curricula, and directly allocated funds to every school for all operating and capital expenditures. The Education Act 1989 and subsequent amendments radically restructured the delivery of educational services. While New Zealand does not have a full voucher system, parents have far greater choice in primary and secondary education than in the UK. In most areas, parents may choose to enrol each of their children in one of several competing Crown Entity schools.

Under the Act, all state-owned schools, polytechnics, and universities were transformed into autonomous Crown Entities that must *outline their educational goals and methods in a charter*. A *parent-elected board of trustees* governs each state-owned primary and secondary school, selecting its own headmaster, determining policy, and allocating funds. Independent councils govern state-owned polytechnics and universities. The Ministry is now confined to providing policy advice, developing national curricula, chartering schools, and providing funding to these institutions according to government policy. Tertiary education is bulk funded based on the number of students and the courses they are taking. Primary and secondary schools are converting from direct line-item allocations to bulk funding based on the number of students enrolled. Limited bulk funding is also available to private schools.[82]

**Health care**. A key to reforming health care has been *the separation of purchasing from service delivery*.[83] Health services were substantially restructured as of 1 July, 1993. The old Department of Health was abolished, and a new Ministry of Health, four Regional Health Authorities, and twenty-three Crown Health Enterprises were created. Public hospitals were transformed into Crown Health Enterprises (similar to NHS Trusts), which must now compete with private hospitals and physician-owned out-patient clinics for patients and funding.[84] The Ministry provides health policy advice to the government. A Crown Entity, the Public Health Commission, monitors public health needs and purchases public health services. The four Regional Health Authorities are Crown Entities that contract with Crown Health Enterprises, private hospitals, and physicians to purchase health care and disability services.

## Lessons for the UK

A series of reforms known as the Next Steps Initiative have been implemented in the UK, but they were far more modest that those of New Zealand. In New Zealand all senior officials were designated as Chief Executive Officers, not just those heading the agencies as in the UK. Furthermore a much sharper distinction was made between executive agencies and policy-making departments. In the UK the departments still have a responsibility for their agencies, which leads to a blurring of accountability (reflected in the recent public concern about the evident confusion over the division of responsibilities between the Head of the Prison Service and the Home Secretary).

# 6 Fiscal transparency and accountability

Beyond restructuring, New Zealand has sought to increase the transparency in the state sector and ensure accountability at all levels of government through the Public Finance Act 1989 and the Fiscal Responsibility Act 1994. Prior to its structural reform, New Zealand's fiscal policy was a mess. Government spending swelled from 27.5 percent of GDP in the 1971/72 March year to 40.7 percent of GDP in the 1983/84 March year.[85] Under the Lange government, spending declined somewhat to 37.3 percent of GDP in the 1990/91 March year.[86] Between 1970/71 and 1990/91 March years, real per capita taxes soared from NZ$4,349 to NZ$7,564 (in 1990 NZ$s).[87] In 1984, the International Monetary Fund described New Zealand's fiscal deficit, which at time was 6.5 percent of GDP, as "a major imbalance in the economy that had become more serious [and] threatened to have a severe destabilizing effect on the economy."[88] By the 1990/91 fiscal year, the deficit was still 3.6 percent of GDP.[89]

### Establishing accountability

The first important step in reforming the fiscal decision-making structure was the Public Finance Act 1989. Prior to this Act, all financial operations were centralized in the Treasury. The Treasury approved all expenditures for consumables and assets, collected all receivables, paid all departmental bills, and managed all Crown funds.

First, the Act sought to *establish lines of responsibility for the use of public financial resources*. It transferred the responsibility for each department's financial operations from the Treasury to the departmental CEO; the CEOs are now *fully accountable for the financial management of their departments*. Each department has a separate account into which taxpayer funds, receipts from departmental revenue, and receipts from the sale of departmental assets are placed. All department bills, including employee salary and benefits, are paid out of this account.[90]

Second, the Public Finance Act 1989 clarified the different functions and responsibilities of Ministers and their departmental CEOs, by *clearly distinguishing between inputs, outputs and outcomes*. The politicians in the Parliament and the Cabinet determine policy; departmental CEOs are responsible for efficient output production.

Each year then, the Cabinet establishes goals for policy outcomes. Based on these outcome goals, the Cabinet, acting through the Minister of Finance, recommends an annual Budget to Parliament prior to the beginning of each fiscal year. Whilst the Budget is being finalized the Minister responsible for each department then determines what departmental outputs — goods and services — would help the government achieve its outcome goals.[91] Now, the responsible Minister negotiates a detailed annual outputs agreement with his departmental CEO, specifying what outputs are expected to be produced and how the outputs will be measured or evaluated. Once this agreement is concluded, it is tabled in Parliament and made a part of the public record.[92]

**Inputs, Outputs, and Outcomes**

**Inputs** are all resources used by a government to produce goods or services. Inputs may include money, labour supplied by employees, services supplied by outside contractors, technical knowledge legally protected by patents or copyrights, raw materials, consumable supplies, land, buildings, and equipment. Unlike private businesses, governments have traditionally used inputs, especially annual appropriations, to measure their success. For example, armed forces are often assessed by the amount of taxpayers funds spent, the number of soldiers kept in uniform, and the quantity of weapon systems owned. Schools are often evaluated by per pupil expenditures or teacher-pupil ratios. Police forces are measured by size and pay of the force relative to the community.

**Outputs** are the goods and services produced by a government. Outputs are specific, achievable and measurable tasks. For example, government outputs may include (1) destroying the headquarters of a terrorist group, (2) teaching children to read at an appropriate age level, or (3) maintaining an average response time to emergency police calls of less than 5 minutes.

In contrast to outputs, **outcomes** are the impact on, or the consequences for, the community of the outputs of government. Outcomes are broadly stated public policy objectives, such as (1) deterring terrorist acts, (2) increasing skill level of future members of the labour force, or (3) reducing domestic crime. Outputs are used to achieve outcomes.

Third, the Public Finance Act 1989 *makes CEOs responsible for the efficient production of departmental outputs*. Unlike the UK, departmental CEOs have broad authority to decide how the agreed outputs will be produced. The State Sector Act 1988 had granted CEOs wide powers to hire, fire, and reward departmental personnel.

The Public Finance Act 1989 gave CEOs similar authority over other *production inputs*. Within an asset cap, CEOs may buy, lease, or dispose of equipment and facilities. CEOs may decide to produce goods and services in-house or to contract them out to private firms. Central controls on office supplies, office space, computing, and inputs from other government agencies were abolished.[93] CEO compensation is now tied to how efficiently the department operates. The annual output agreement gives Ministers a reasonably objective tool to evaluate the performance of departmental CEOs in New Zealand. Taking the principle even further, Ray Reardon has proposed some very specific measurements of UK departmental efficiency in the Adam Smith Institute paper, *Benchmarking the Civil Service*.[94]

**Cash accounting versus accrual accounting**

*Cash accounting* records money received at the time it is banked, and money spent at the time it is paid out. *Accrual accounting* relates financial activities to the period in which they occur regardless of whether money changes hands. *Cash accounting* does not provide adequate information to measure the full cost of producing goods and services. *Accrual accounting* is more complete because (1) accrual accounting, unlike cash accounting, records non-cash expenses, and (2) accrual accounting, unlike cash accounting, tracks assets and liabilities and records changes in their value.

Accrual accounts for government will differ substantially from cash accounts in the same period. For example:

> *Accrual accounting* shows as assets the value of receivables, amounts due but not yet paid to government for goods and services provided or taxes levied. *Cash accounting* ignores receivables.
>
> *Accrual accounting* shows as liabilities the value of payables, amounts owed but not yet paid by government to employees and suppliers. *Cash accounting* ignores payables.
>
> *Accrual accounting* reports the value of government assets such as office buildings, and aircraft carriers, and reflects changes in their value through depreciation. *Cash accounting* omits assets.
>
> *Accrual accounting* records the value of non-cash liabilities that are frequently large in government such as unfunded pension liabilities. *Cash accounting* ignores non-cash liabilities.

## Financial transparency

Fourth, the Finance Act 1989 mandated that the New Zealand government would *switch from cash accounting to accrual accounting*, based on Generally Accepted Accounting Practice (GAAP) for financial budgeting and management purposes. Since 30 June 1991, all departments have been required to produce annual financial statements on the basis of Generally Accepted Accounting Practice (GAAP). The departmental financial statements include an operating statement, a balance sheet, a cash flow statement, a statement of objectives, and state of service performance. The departmental financial statements for the 1991/92 fiscal year were combined with other financial transactions on behalf of the state into the first comprehensive, accrual-based financial statement for any national government in the world.[95]

While cash accounting may accurately depict cash flows, accrual accounting is universally recognized as providing a more comprehensive view of an organization's operations and financial condition. Unlike cash accounting, accrual accounting *records the changes in value of assets and liabilities and distinguishes between operating and capital flows,* thus providing a much better assessment of the state's true financial position. For example, when Barry Bracewell-Milnes applied accrual accounting to UK inheritance taxes in his Adam Smith Institute paper *Free Wills*, he discovered that for most of the last century they had been producing a negative yield, actually reducing government revenue.[96] The switch from cash to accrual accounting in New Zealand revealed a very disagreeable, but previously hidden fact. When New Zealand published its first financial statement for fiscal year 1992/93, Kiwis were horrified to learn that their government was literally bankrupt with a negative net worth of nearly NZ$7 billion. This knowledge helped to force policy changes that are expected to produce a positive net worth by June 1996.[97] While adopting accrual accounting and budgeting is technical, it is a necessary precondition for identifying inefficiencies, improving services, and saving taxpayers money in the UK context, just as it is in New Zealand.

**What are GAAP?**

*Generally Accepted Accounting Principles* or Generally Accepted Accounting Practice in New Zealand (GAAP) are the guidelines, procedures, and practices that must be followed to record and report accounting information in audited financial statements. GAAP define accepted accounting practices at a particular time and provide a standard by which to report financial results. For accountants, GAAP are like laws that must be obeyed in financial reporting.

The Accounting Standards board (ASB) of the UK is the primary source of authoritative GAAP. It works closely with professional accounting organisations in other countries through the International Accounting Standards Committee (IASC) to ensure consistent accounting procedures throughout the world.

Fifth, the Public Finance Act 1989 also instituted a *capital charge system*. New Zealand recognizes the cost of capital in its budget and accounting systems. Each department is levied a capital charge, based on the total value of departmental assets and the average interest rate on long-term government debt. The capital charge is paid to the Treasury twice a year. Unlike the UK where capital is cost-free to government departments (although not to NHS trusts), the capital charge creates a strong incentive for Kiwi CEOs to minimize their use of assets. In recent testimony before the US House of Representatives Committee on Government Reform and Oversight, New Zealand Ambassador John Wood commented on the effectiveness of the capital charge in changing bureaucratic behaviour and forcing economic trade-offs:

> Let me give you a small example from my own experience here in Washington. At the Ambassador's Residence, the Foreign Ministry owns a number of paintings by New Zealand painters which were purchased 20 years ago for a very modest sum. These have now appreciated to where their capital value in several hundred thousand dollars. Being faced with paying a twice yearly capital charge on this capital value certainly sharpens my decision-making as to whether I would rather spend some thousands of dollars each year to have these works of art on the wall, or whether we might not be better off selling the paintings and using our resources elsewhere.[98]

## Fiscal responsibility: principles

To strength fiscal responsibility, the Bolger government enacted the Fiscal Responsibility Act 1994. While the Public Finance Act 1989 changed the financial incentives for CEOs within departments, the Cabinet did not yet have a fiscal constitution — a legal framework that would promote overall fiscal responsibility.

Twice in recent years, new governments — Labour in 1984 and National in 1990 — found ugly fiscal surprises. During the 1990 election, the Labour government knew about the Bank of New Zealand insolvency, but kept it secret from the National Party opposition. After the election, the Ombudsman criticized the failure of the Labour government to disclose the BNZ insolvency. Public demands for full and frequent disclosure of all fiscal and economic information increased.[99]

The National Party Minister of Finance Ruth Richardson strongly believed that accumulating government debt to finance consumption was not only an economic but also a moral issue — today's politicians should not burden future generations with higher taxes to pay for current consumption. She was also frustrated by how easily short-term concerns about Ministers' own portfolios could overwhelm long-term economic and fiscal considerations. To address this imbalance, she developed a legal framework to bind the Cabinet and Parliament to pursue sound fiscal policies.[100]

Minister Richardson introduced the Fiscal Responsibility Bill in September 1993. Although she returned to the back of the benches soon afterwards, she continued to work as Chairman of the Parliament's Finance and Expenditure Committee with new Minister of Finance Bill Birch to see the bill through to enactment in June 1994. The Act established the following principles of responsible fiscal management:[101]

- *Reducing total Crown debt to prudent levels* by achieving operating surpluses every year until a prudent level of debt has been attained.

- *Maintaining total Crown debt at a prudent level* by ensuring that on-average operating expenses of the Crown do not exceed operating revenue.

- *Achieving and maintaining levels of Crown net worth* that provide a buffer against adverse future events.

- *Prudent management of the fiscal risk* facing the Crown.

- The pursuit of policies consistent with a reasonable degree of predictability about the *level and stability of tax rates* in future years.[102]

Any deviation from these principles must be both temporary and transparent.[103]

## Fiscal responsibility: practice

Under the Fiscal Responsibility Act 1994, the government must develop an annual *Budget Policy Statement* and present it to Parliament not later than March 31 of each year. The Budget Policy Statement outlines the government's fiscal intentions over the next three fiscal years in reference to the principles of fiscal policy set forth in the Act.[104]

The Budget, when introduced, must be accompanied by a *Fiscal Strategy Report*, which compares actual economic and fiscal information and decisions in the Budget with the intentions laid out in the Budget Policy Statement. The Fiscal Strategy Report must also *forecast the effect of current economic and fiscal policies over the next ten years*.[105] In December of each year and before a general election, the Act requires the Treasury to publish an economic and fiscal update and forecast for the next three years.[106]

To ensure full disclosure of relevant economic and fiscal information and prevent over-optimistic budgeting, the Act mandates that the Minister of Finance and the Secretary of the Treasury, the Treasury's CEO, should accept *personal responsibility for all economic and fiscal reports* required under the Act. In each report, the Minister of Finance must attest that all government policy decisions and other circumstances with material economic or fiscal implications have been disclosed to the Secretary of the Treasury. Likewise, the Secretary of Treasury must attest that the Treasury has incorporated all information disclosed by the Minister and employed its best professional judgement in making all economic and fiscal data projections.[107]

The Fiscal Responsibility Act 1994 attempts to minimize the short-term bias in the democratic process, identified by public choice economists, that can undermine financial responsibility. For example, politicians often favour unnecessary expenditures for special interest groups when the benefits are highly concentrated but the costs are widely spread. Likewise, politicians often engage in excessive deficit spending because future generations of taxpayers who must bear the cost are underrepresented in today's electorate. To reduce the bias towards short-term expediency, the Act requires the government to compare actual and forecast fiscal aggregates to principles of sound fiscal management established in the Act and to justify any deviation from those principles. Thus, Parliament and the public are more likely to focus on the long-term consequences of fiscal policy decisions rather than their immediate impact on individuals and programmes.[108]

## Results of the reforms

Together the Public Finance Act 1989 and the Fiscal Responsibility Act 1994 have helped New Zealand to achieve a remarkable fiscal turnaround. Estimated government expenditures for the current 1995/96 fiscal year are 35.1 percent of GDP, down from the peak of 40.7, and are forecast to continue to decline to 30.5 percent by the 1998/99 fiscal year. New Zealand is expected to generate an operating surplus of 3.3 percent of GDP in the 1995/96 fiscal year, producing a positive net worth of an estimated NZ$2 billion by 30 June, 1996, for the first time. Net government debt outstanding is estimated to fall to 33.4 percent of GDP by 30 June 1996, down from the peak of 51.8 percent of GDP.[109] Standard & Poor upgraded New Zealand's credit rating on 31 January 1996 from AA to AA plus, and Moody's is expected to follow.

Moreover, Kiwi taxpayers will soon reap more benefits from New Zealand's financial probity. On 19 February 1996, Minister of Finance Bill Birch announced a substantial two-year income tax rate reduction. The first phase, effective 1 July 1996, will cut the basic personal income tax rate of 24 percent to 21.5 percent while the second phase will cut the basic rate further to 19.5 percent effective 1 July 1996.[110] By reprogramming funds that are no longer needed for interest as net government debt outstanding falls, the Bolger government can increase spending on high priority social and health care initiatives while keeping total spending flat.[111]

# 7 A monetary constitution

With the passage of the Reserve Bank of New Zealand Act, New Zealand radically altered its monetary constitution, the legal and operational framework in which monetary policy is executed. This revolutionary monetary change complements New Zealand's fiscal reformation. Moreover, the Reserve Bank Act 1989 is a model for reforming monetary constitutions around the world. Indeed, Dr Charles Hanson has proposed the New Zealand model for the UK in the Adam Smith Institute paper *Exorcising Inflation*.[112]

**What is a monetary constitution?**

A monetary constitution is the legal framework and generally accepted goals, procedures, and practices within which monetary policy is conducted. A monetary constitution is not necessarily contained in a single written law. While national legislatures do enact organic laws to charter central banks, unwritten custom or informal policy may be just as important constraint on central bank decision-making. Two of the most important features of a monetary constitution are: (1) the determination of what rule, if any, will guide central bank monetary policy formulation, and (2) the degree of independence which a central bank may enjoy in executing policy from the national executive. Central bank charters are frequently silent on whether a central banks should use a price rule, a quantity rule, or no rule at all to determine the rate of money creation. Likewise, custom and political power frequently limit the real degree of central bank independence.

New Zealand's central bank, the Reserve Bank of New Zealand, was established in 1934 as a privately-owned institution, but was nationalized in 1936. Like central banks in other developed countries, the Reserve Bank laboured for many years under a conflicting mandate. The Reserve Bank Act 1964 stated that monetary policy "shall be directed to the maintenance of economic and social welfare in New Zealand, having regard to the desirability of promoting the highest level of production and trade and full employment, and of maintaining a stable internal price level."[113]

## The purpose of monetary policy

The proper goal for monetary policy is *zero inflation*. A stable price level reduces uncertainty, encourages long-term planning, and directs scarce resources away from speculation. Therefore, a stable price level increases saving and investment in the economy. Consequently, a stable price level will over time increase economic efficiency, boost economic growth, and increase the wealth of citizens.

Unfortunately, most central banks operate under charters that do not establish price stability as the bank's sole mission. Instead, central banks work to conflicting mandates to maintain price stability, maximize output and employment, and other competing goals. However, no person or organization can mathematically maximize two or more independent goals at once. Multi-goal charters cause confusion in central bank policy. Central bankers may be tempted to focus on what they cannot affect — output and employment — instead of what they can control — the price level.

Empirical studies suggest an inverse correlation between the degree of autonomy that a central bank enjoys from political authorities and inflation rates over time. Increasing central bank accountability also improves inflation performance. Accountability is achieved by a setting a single goal of price stability and sanctioning central bank governors for any significant deviations from this goal.

## The New Zealand reforms

Despite progress in economic liberalization during the mid-1980s, New Zealand still suffered from an inflation problem — the Consumer Price Index rose 7.0 percent in the 1989/90 March year.[114] The government was determined to effect an institutional change that would lead to long-term price stability. With the support of both the then Labour government and National Party opposition, the Reserve Bank Act was passed in 1989. Section 8 of the Act replaced the multiple objectives of the past with a single clear goal:

> The primary function of the Bank is to formulate and implement monetary policy directed to the economic objective of achieving and maintaining stability in the general level of prices.[115]

The Act does not define price stability but instead requires the Reserve Bank Governor and the Minister of Finance to *agree to a precise definition* in a Policy Targets Agreement (PTA). The current PTA defines price stability as an inflation rate of 0 to 2 percent, as measured by the Consumer Price Index.[116]

Under the Act, the government has the responsibility to set the objectives for monetary policy. The Reserve Bank differs from the Fed in the US or the Bundesbank in Germany both of which set their own inflation targets. The Act permits the government to override the price stability goal in emergencies, but *only by renegotiating the PTA* and making a new PTA public. The Act clearly defines separate roles for the government and the Reserve Bank. The government is responsible for establishing the goals for monetary policy.[117] Once established, the Reserve Bank may conduct monetary policy as it sees fit, free of any instructions or other interference from the government.[118]

With operational autonomy, the Act demands *full accountability* from the Reserve Bank and its Governor. The Governor's compensation is tied to the Bank's inflation performance. Moreover, the Governor may be dismissed if the Reserve Bank consistently exceeds its inflation target. Finally, the Reserve Bank must also issue a public report and evaluation of its performance, the *Monetary Policy Statement*, every six months.[119]

### Results

Since the Act was passed, New Zealand has enjoyed a steady improvement in price performance. Inflation has been substantially reduced. Consequently, interest rates have fallen as the inflation premium has melted. The yield on ten-year New Zealand bonds has dropped from 13 percent in 1990 to around 7.2 percent for the March 1996 quarter. Inflationary expectations have been reduced, allowing Kiwis to focus on investing for the future.[120]

# 8 Labour market reform

New Zealand adopted the Industrial Conciliation and Arbitration (IC&A) Act 1894 to promote the development of industrial unions. A union registered under the Act had the sole right to bargain for workers covered by its membership rules; workers were not permitted to select their own bargaining agent. Registered unions negotiated labour contracts, known as awards, with employers' groups. Such awards were binding on all employers and their workers in the covered industry even if they had not participated in the negotiations or agreed to the outcome. In 1936, union membership became compulsory and remained so except for a brief period in 1983. The IC&A was replaced by the Industrial Relations Act 1973 which in turn was replaced by the Labour Relations Act 1987. However, these subsequent Acts did not change the operational principles of the IC&A.[121]

In 1991, the Bolger government pushed the world's most advanced labour-management relations law through Parliament. The Employment Contracts Act 1991 revolutionized labour-management relations in New Zealand. The Act fosters employer-employee co-operation rather than confrontation.[122] Consequently, New Zealand now has the most flexible labour market in the world with the possible exception of Hong Kong.

### Effect of the legislation

Unlike the Labour Relations Act 1987, which applied only to employers subject to awards, the Employment Contracts Act 1991 covers all employers and employees; it is illegal to contract out of the Act.[123] The Act outlaws compulsory unionism: every employee has *a legal right to belong or not belong to any employee organization* as he or she freely chooses and to elect who may represent him or her in bargaining with his or her employer. Each employee may bargain for himself, hire an agent to bargain for him, or join an employee organization to bargain collectively. Unions are *forbidden to pressure any employee into joining, remaining with, or leaving a union*. Likewise, *employers are forbidden to give any preference to any employee* based on his or her choice about union membership.[124]

The Act established two types of contracts: individual and collective. An individual employee covered by a collective contract may agree with his or her employer *to opt out of certain provisions of a collective contract* and tailor terms and conditions particular to that individual, provided these terms and conditions are not less favourable to the employee than those in the collective contract.[125]

Employment contracts must be consistent with other legislation, particularly on workplace health and safety.[126] Otherwise, the Act leaves employers and workers free to bargain over other issues.[127]

*Each employee has a right to choose who may negotiate on his or her behalf* with the employer; employers must respect these rights. If 30 percent of workers want a one union, 10 percent choose another, and 60 percent elect to negotiate for themselves, then a Kiwi employer must negotiate a separate collective contracts with each union and individual contracts with non-union employees.[128]

Indeed, Kiwi unions, stripped of old their jurisdictional monopolies, actively compete against each other for members. Such competition has forced unions to improve their member services, cut costs, and reduce extraneous activities. Unions must now provide a valued negotiating service if they are to keep subscription-paying members.

New Zealand's Employment Contracts Act 1991 also sets *criteria for when strikes and lock-outs are legal and illegal*. Strikes and lockouts are legal as a negotiating tool by either party once a collective bargaining contract has expired. Strikes and lockouts are also lawful when employers or employees have reasonable grounds to believe their action is justified by an immediate threat to life, health, or physical safety. Strikes and lock-outs are illegal when they (1) occur while a collective employment contract is in force, (2) relate to a personal grievance, (3) are concerned whether a collective contract should apply to more than one employer, (4) are in an essential industry as defined by law and required 14 day notice has not been given, and (5) violate a Court order. The Employment Court may issue injunctions to terminate illegal strikes and lockouts.[129]

# 9 Recommendations

New Zealand has successfully reformed its state sector during the last decade. The principles of public choice that New Zealand employed provide a sound foundation for reforming British government. Heeding these lessons, we recommend that the UK should:

- *Reorganize the entire executive, breaking up large departments with combined policy advice, regulatory, service delivery, and commercial trading functions and locating these functions in separate organizations.* Vesting policy advice in a large agency that has other regulatory, service delivery, and commercial trading functions produces an inherent conflict of interest. Departmental employees are unlikely to give the administration objective evaluations of other functions executed by their own department. Internal advisers will always tend to advocate a larger budget and more powers for their department, no matter what its performance. Placing policy advice in a separate agency from other functions will tend to reduce this bias. New Zealand has found that ministry officials can be far more critical of departmental operations if regulatory and service delivery functions are handled by separate, autonomous agencies.

- *Require the Secretaries of State to enter into explicit contracts for government outputs from the agencies under their direct supervision.* Contracts for departmental outputs between the ministers and various government agencies would increase public accountability for executive branch operations. Officials would know exactly what output is expected from their agency. Output contracts allow Parliament and the public to measure how well agencies are performing in an objective fashion.

- *Place senior members of the Civil Service on individual performance-based employment contracts.* Once output contracts are in place, the compensation of Civil Servants should be tied explicitly to their individual performance in producing the agreed output. Thus, officials would face a similar incentive system to their counterparts in the private sector.

- *Authorize the ranking Civil Servant in each agency to hire, fire, and reward personnel, contract for goods and services, and make capital expenditures within their existing asset base. The UK government should copy New Zealand and manage government operations by monitoring outputs rather than controlling inputs.* Focusing on inputs biases the political process toward larger, more expensive government. For example, government officials too often evaluate educational quality by measuring per-pupil expenditures rather than student performance. In education and welfare, more expenditure has not produced better services. Once output measures are established, officials should then exercise broad authority to manage personnel in their department and select other inputs to achieve their targeted outputs in the most cost-effective way. They should be able to buy, lease, or dispose of equipment and facilities within their existing asset base. They should also be free to produce services in-house or contract out to private suppliers.
- *Adopt accrual-based Generally Accepted Accounting Principles (GAAP) for government budget and financial management purposes.* While adopting accrual accounting and

budgeting in government may seem technical, it is a necessary precondition to make the other recommendations work.

- *Apply a capital charge to the budget of each department and agency.* Capital should not be a free good. Levying a capital charge, based on the average interest rate of government bonds, would create a strong incentive for government managers to economize on their use of assets.

- *The Bank of England should be granted independence.* It should have one mission only: price stability. The policies of the Bank of England should be overridden only in emergency and in a publicly accountable manner. The Governor's salary should be related to the inflation performance, and subject to dismissal if the Bank consistently fails in its inflation target.

**Summary**

Over the last decade, New Zealand has been the world's laboratory in which many state sector reforms have been put into practice. The New Zealand experience provides the UK with a guide book on how to reform the government to reduce expenditures, lower taxes, and improve service delivery. Too often, the British think they are different and special and therefore cannot learn anything useful from experiences abroad. In this case, sending ministers and MPs on a taxpayer-financed trip to New Zealand would not be a junket, but rather a good investment. If our politicians — from whichever party — seek a model on how to change Britain for the good, they need merely book a flight to Auckland.

## **Crown Entities,** as of 22 November 1995

Accident Rehabilitation and Compensation Insurance Corporation
Accounting Standards Review Board
Agriculture and Marketing Research and Development Trust
Alcoholic Liquor Advisory Council
Animal Control Products Limited
Arts Council of New Zealand Toi Aotearoa
Asia 2000 Foundation of New Zealand
Auckland International Airport Limited
Blood Transfusion Trust
Building Industry Authority
Broadcasting Standards Authority
Business Development Board (21)
Careers Service
Casino Control Authority
Civil Aviation Authority of New Zealand
Commerce Commission
Commissioner for Children
Crown Health Enterprises (23)
Crown Research Institutes (10)
Early Childhood Development Unit
Earthquake Commission
Electoral Commission
Fish and Game Councils(13)
Foundation for Research Science, and Technology
Government Superannuation Board
Health and Disability Commissioner
Health Sponsorship Council
Hillary Commission for Sport, Fitness, and Leisure
Housing Corporation of New Zealand
Housing New Zealand Limited
Human Rights Commission
International Year of the Family Trust
Land Transport Safety Authority of New Zealand
Law Commission
Learning Media Limited
Legal Services Board
Management Development Centre Trust
Maritime Safety Authority of New Zealand
Museum of New Zealand Te Papa Tongarewa
New Zealand Artificial Limb Board
New Zealand Film Commission
New Zealand Fire Service Commission
New Zealand Fish and Game Council
New Zealand Game Bird Habitat Trust Board
New Zealand Government Property Commission
New Zealand Lotteries Commission
New Zealand Lottery Grants Board
New Zealand on Air
New Zealand Qualifications Authority
New Zealand Sports Drug Agency
New Zealand Symphony Orchestra Limited
New Zealand Tourism Board
New Zealand Trade Development Board
Office of Film and Literature Classification
Pacific Island Employment Development Board
Police Complaints Authority
Privacy Commissioner
Public Health Commission
Race Relations Conciliator
Radio New Zealand Limited
Regional Health Authorities (4)
Reserve Boards (60)
Residual Health Management Unit
Retirement Commissioner
Road Safety Trust
School Boards of Trustees (2,677)
Securities Commission
Special Education Service
Standards Council
Takeovers Panel
Te Reo Whakapuaki Irirangi (Te Mangai Paho)
Te Taura Whiri I Te Reo Maori (Maori Language Commission)
Teacher Registration Board
Tertiary Education Institutions (39)
Testing Laboratory Registration Council
The New Zealand Game and Fish Council
The Power Company Limited
Transit New Zealand
Transport Accident Investigation Commission
Trustees of the National Library
Wellington International Airport Limited

## **Departments,** as of 22 November 1995

Agriculture
Commerce
Conservation
Corrections
Courts
Crown Law
Cultural Affairs
Customs
Defence
Education Review Office
Environment
Fisheries
Foreign Affairs and Trade
Forestry
Government Communications Security Bureau
Government Superannuation Fund
Health
Housing
Inland Revenue
Internal Affairs
Justice
Labour
Maori Development
National Library
Office of the Clerk
Pacific Island Affairs
Parliamentary Counsel Office
Parliament Service
Police
Prime Minister and Cabinet
Research, Science, and Technology
Security Intelligence Service
Serious Fraud Office
Social Welfare
State Services Commission
Statistics
Survey and Land Information
Transport
Treasury
Valuation
Women's Affairs
Youth Affairs

## Notes

[1] The government refers to the Prime Minister and other Ministers who together constitute the Cabinet and perform the executive functions of the New Zealand state. The state or Crown refers to the New Zealand government as a whole, including the Governor-General, Parliament, the Prime Minister and other Ministers, Crown Departments, Crown Entities, State-Owned Enterprises (SOEs), the Court of Appeals, the High Court, District Courts, and specialised courts.

[2] His Excellency John Wood, Ambassador to the United States, "New Zealand: A Blueprint for Economic Reform, *The Heritage Foundation Lectures*, 16 June 1995, p. 1.

[3] Public Service is the formal name for New Zealand's civil service.

[4] Reserve Bank of New Zealand Act 1991, Section 8.

[5] World Competitiveness Report, Geneva: World Economic Forum, September 1995.

[6] "Economic Freedom: Of Liberty and Prosperity", *The Economist*, January 13, 1996, p.23; James Gwartney, Robert Lawson and Walter Block, *Economic Freedom of the World*, Washington, D.C.: Cato Institute, 1996; Bryan T. Johnson and Thomas P. Sheehy, *1996 Index of Economic Freedom*, Washington, D.C.: The Heritage Foundation, 1996, pp. xxvi-xxix.

[7] Freedom House, *Freedom in the World 1994-95*, pp. 678-680.

[8] In New Zealand, Statistics New Zealand compiles national economic data based on years ending on March 31, referred to as a March year. The New Zealand Treasury compiles fiscal data based on years ending on 30 June, referred to as a fiscal year.

[9] Rt. Hon. Bill Birch, Minister of Finance, *Economic and Fiscal Outlook 1995*, 23 May 1995, p. 17.

[10] *Economic and Fiscal Outlook 1995*, p. 41.

[11] *Economic and Fiscal Outlook 1995*, p. 58; and historical data derived from the New Zealand Treasury and Statistics New Zealand.

[12] Douglas, p. 10.

[13] Douglas, p. 23.

[14] *New Zealand Official Year Book 1995*, 98th ed., Wellington: Statistics New Zealand, 1995, pp. 544-546.

[15] Rodney Hide and Owen McShane, *Can Privatization Succeed in a Western Democracy, Lessons from New Zealand*, March 1995, pp. 4-5.

[16] Wood, 16 June 1995, p. 2.

[17] David Galt, "Industry and Trade Policies, in *Rogernomics*, p. 164.

[18] Grant Spencer and David Carey, "Financial Policy Reform," in *Rogernomics: Reshaping New Zealand's Economy*, Simon Walker, ed., Auckland: New Zealand Centre for Independent Studies, 1989, p. 50.

[19] Roger Douglas, *Unfinished Business*, Auckland: Random House New Zealand Ltd., 1993, p. 14; and *Economic Report of the President*, Washington: U.S. Government Printing Office, February 1995, p. 328.

[20] Spencer and Carey, pp. 49-50.

[21] Spencer and Carey, p. 50.

[22] Douglas, pp. 26-30.

[23] Hide and McShane, p. 4.

[24] In 1984 among financial services, the Crown owned the largest commercial bank (the Bank of New Zealand), the largest savings bank (the Post Office Savings Bank), the largest insurer of motor vehicles (State Insurance), the largest farm mortgage lender (the Rural Banking and Finance Corporation), the largest residential landlord and mortgage lender (the Housing Corporation of New Zealand), and one of the largest investment banks (the Development Finance Corporation). Among utilities, the Crown owned the telephone, electricity generation and wholesale distribution industries. In energy, the Crown owned the major producer of coal (State Coal), the dominant natural gas supplier (the Natural Gas Corporation), and a major supplier of petroleum products (Petrocorp). In transportation, the Crown owned the railroad, a major bus network, the inter-island ferry service (all through the Railways Corporation), the sole national airline (Air New Zealand), and a national shipping line (the New Zealand Shipping Corporation). In broadcasting, the Crown owned the only two television channels and

all nation-wide radio networks. The Crown also owned a major hotel chain (the Tourist Hotel Corporation), the postal system, and more than half of New Zealand's commercial forests.

[25] *The Public Benefit of Private Ownership: The Case for Privatization*, New Zealand Business Roundtable, June 1992, pp. 1-2.

[26] Derived from New Zealand Treasury and Statistics New Zealand data.

[27] Hide and McShane, p. 3.

[28] Includes New Zealanders employed in Crown make-work schemes.

[29] Colin James, "Overview," in Rogernomics, p. 4.

[30] James, p. 8.

[31] *Year Book*, p. 16.

[32] *Year Book*, p. 16.

[33] Douglas, pp. 37-52.

[34] *Year Book*, p. 16.

[35] New Zealand Ministry of Foreign Affairs and Trade, 1995.

[36] New Zealand Ministry of Foreign Affairs and Trade, 1995.

[37] Wood, 16 June 1995, p. 2.

[38] Unlike most developed countries, New Zealand does not levy payroll taxes to fund its social insurance programs. Nor does New Zealand have any income or payroll taxes levied by subsidiary governments (state, province, region, county, or city). Nor does New Zealand tax capital gains. New Zealand provides certain limited rebates against taxes payable for minor children, child care costs, low income, net deposits in special home, farm, and fishing vessel ownership accounts, and charitable donations.

[39] Rt. Hon. Jim Bolger, "Privatization: The New Zealand Experience," Wellington: Office of the Prime Minister, November 20, 1992, pp. 5-6.

[40] Contestability is the threat of entry of another producer into a market.

[41] The Commerce Act prohibits (1) anti-competitive collusive and unilateral behaviour and (2) mergers that create or strengthen a dominant market position

[42] The Fair Trading Act (1) prohibits deceptive conduct and misleading advertising, and (2) provides for information disclosure and product safety standards.

[43] Bolger, p. 6.

[44] Bolger, p. 6.

[45] Hide and McShane, p. 11.

[46] Hide and McShane, p. 11; and *Public Benefits*, p. 5.

[47] Hide and McShane, p. 11; and *Public Benefits*, pp. 5-6.

[48] *Public Benefits*, P. 6.

[49] *Public Benefits*, p. 6; and Bolger, p. 6.

[50] *Public Benefits*, pp. 6-7.

[51] *Public Benefits*, p. 7; and Bolger, p. 6.

[52] Hide and McShane, pp. 12-13; and *Public Benefits*, pp. 8-9.

[53] *Public Benefits*, p. 9.

[54] Hide and McShane, p. 13; and *Public Benefits*, pp. 9-10.

[55] Hide and McShane, p. 12; and *Public Benefits*, pp. 10-11.

[56] Hide and McShane, p. 13; and *Public Benefits*, p. 11.

[57] Bolger, p. 9; and *Public Benefits*, pp. 12-13.

[58] Bolger, p. 8.

[59] *Privatization: The Lessons of Experience*, Country Economics Department, World Bank, 1992, p. iii.

[60] S&P Australian Ratings, Monthly Ratings Bulletin, *State-Owned Enterprises*, May 1992, pp. 13-15.

[61] Bolger, p. 7; and Hide and McShane, p.10.

[62] Bolger, p. 9.

[63] Bolger, p. 9; and Hide and McShane, p. 10.

[64] New Zealand Treasury.

[65] *Public Benefits*, p. 17.

[66] Bolger, p. 8.

[67] *Public Benefits*, p. 16.

[68] *Public Benefits*, p. 16.

[69] Bolger, pp. 7-8.

70 *Public Benefits*, p. 19.
71 *Public Benefits*, pp. 19-20.
72 Bolger, p. 9; and *Public Benefits*, p. 20.
73 Hide and McShane, pp. 13-14; and *Public Benefits*, pp. 20-21.
74 *Public Benefits*, pp. 21-22.
75 Public choice is the economic study of non-market decision-making. The subject matter of public choice is the same as political science — theory of state, voting behaviour, political parties, bureaucracy, etc., but the methodology, economics, is different. Public choice begins with the behavioural assumption that man is an egoistic, rational utility-maximizer.
76 Before reform, there were two control departments, the Treasury and State Services Commission, and a number of large public service departments under the Cabinet. Through the control departments, the Cabinet centralized the management of the entire government. The Treasury directed all expenditures through centralized consumables and assets purchasing while the State Services Commission employed all personnel in the Public Service. The large public service departments such as the Ministry of Education, the Ministry of Energy, or the Ministry of Works and Development performed a number of conflicting functions: policy advice, regulatory, service delivery, and commercial trading. Numerous "quasi non-government organizations" (quangos) were funded mainly with state grants. Additionally, a small number of "government corporations" operated commercially but under the strategic direction of the government All department, quangos, and government corporations utilized a cash-based system of accounting and budgeting.
77 *Year Book*, pp. 28-29.
78 There are 41 line departments, 2,919 Crown Entities and 17 State-Owned Enterprises as 10 May 1995, adjusted for the split of Justice into Corrections and Courts and the separation of Agriculture and Fisheries into two departments, both of which became effective on 1 July 1995.
79 *New Zealand's Reformed State Sector*, Wellington: State Services Commission, 1994, pp. 10-13.
80 *Reformed State Sector*, pp. 10-13; Year Book, p. 29.
81 *Year Book*, p. 8.
82 *Year Book*, pp. 197-202.
83 New Zealand provides its citizens with comprehensive health care benefits funded by general tax revenues. The state pays for all costs of hospital services in public hospitals and most of the costs in private hospitals. The states subsidises the purchase of physician services and prescription drugs. The state also pays for dental services for children. The state accounts for approximately 79 percent of all health care outlays, but 1.3 million New Zealanders are enrolled in private supplemental health insurance plans.
84 *Year Book*, pp. 159-163.
85 Derived from New Zealand Treasury and Statistics New Zealand data.
86 Derived from New Zealand Treasury and Statistics New Zealand data.
87 Derived from New Zealand Treasury and Statistics New Zealand data.
88 Graham Scott, "Improving Fiscal Responsibility," *Agenda*, Vol. 2, No. 1, 1995, p. 6.
89 Derived from New Zealand Treasury and Statistics New Zealand data.
90 Public Finance Act 1989, Sections 18-20; and *Year Book*, p. 522.
91 *Year Book*, pp. 521-522.
92 His Excellency John Wood, Ambassador of New Zealand, "Capital Planning and Budgeting in New Zealand," Testimony before the U.S. House Committee on government Reform and Oversight, 29 June 1995, p. 2.
93 Public Finance Act, Sections 11 and 33; Wood, 29 June 1995, pp. 4-5; and *Year Book*, pp. 521-522.
94 Wood, 29 June 1995, p. 2.
95 Public Finance Act 1989, Sections 27-40; and *Year Book*, pp. 522-523.
96 Barry Bracewell-Milnes, *Free Wills: Inheritance without Taxation*, London: Adam Smith Institute, 1995.
97 Wood, 29 June 1995, pp. 2-3.
98 Wood, 29 June 1995, pp. 5-6.
99 Scott, p. 2.
100 Scott, p. 2.
101 Scott, p. 2.
102 Fiscal Responsibility Act 1994, Section 3.
103 Scott, p. 2; and Fiscal Responsibility Act 1994, Section 4.

104 Fiscal Responsibility Act 1994, Section 6.
105 Fiscal Responsibility Act 1994, Section 7.
106 Fiscal Responsibility Act 1994, Sections 13 and 14.
107 Fiscal Responsibility Act 1994, Section 12.
108 Scott, pp. 9-11.
109 New Zealand Treasury data.
110 Statement of Minister Bill Birch, 19 February 1996.
111 Economic and Fiscal Update, "Statement by Finance Minister Right Honourable Bill Birch", 13 December 1995.
112 Charles Hanson, *Exorcising Inflation*, London: Adam Smith Institute, 1993. See also Geoffrey Wood, Terence Mills and Forest Cappie, *Central Bank Independence: What Is It and What Will It Do For Us?*, London: Institute of Economic Affairs, 1993; Otmar Issing, *Central Bank Independence and Monetary Stability*, London: Institute of Economic Affairs, 1993.
113 Donald T. Brash, "New Zealand Approach to Monetary Policy," An Address to the Asia Society, August 30, 1994, pp. 5-6.
114 Statistics New Zealand.
115 Reserve Bank of New Zealand Act of 1989, Section 8.
116 Brash, pp. 8-9.
117 Brash, pp. 8-9; and Reserve Bank of New Zealand Act 1989, Section 12.
118 Brash, p. 9.
119 Brash, pp. 9-10; Reserve Bank of New Zealand Act 1989, Sections 15 and 49.
120 Brash, pp. 10-11.
121 *Working Together: Employment Relations in the 1990s*, Wellington, New Zealand Employers Federation, November 1992, p. 2.
122 *Working*, pp. 2-3.
123 *Working*, p. 3; and Employment Contracts Act 1991, Section 3.
124 *Working*, pp. 3-4; and Employment Contracts Act 1991, Sections 5-8.
125 *Working*, p. 4; and Employment Contracts Act 1991, Sections 18-20.
126 Occupational health and safety laws include the Factory and Commercial Premises Act 1981 and the Smoke-free Environment Act 1990. The Equal Pay Act 1972 requires men and women performing the same work to receive the same pay. The Parental Leave and Employment Protection Act 1987 guarantees male and female employees the right to take unpaid leave for up to one year on the birth or adoption of a child under the age of five. The Human Rights Act 1977 and the Race Relations Act 1971 forbid various forms of employment discrimination. The Minimum Wage Act 1983 establishes a minimum wage for adults, age 20 or older. The Holidays Act 1981 established 11 public holidays and requires employers to offer 3 weeks paid vacation for every employee who has completed one year of service.
127 *Working*, pp. 14-17.
128 *Working*, p. 6; and Employment Contracts Act 1991, Sections 9-10.
129 *Working*, pp. 10-12; and Employment Contracts Act 1991, Sections 60-74.