

9. Entrenching ‘Rogernomics’ in New Zealand: political and academic perspectives

Jonathan Boston and Sir Roger Douglas

This chapter looks at the case study of public-sector reform in New Zealand in the 1980s and early 1990s, and what underpinned the success in moving this significant reform forward. I will briefly outline the nature of the reforms in question, then propose some explanations as to how these comprehensive, radical, and rapidly introduced reforms were made possible. I will conclude by analysing the outcomes of these reforms, before finally drawing some lessons from the experience. In the second half of the chapter, Sir Roger Douglas will offer his observations from the reform process, as one of its major architects.

Most readers will be aware of the radical changes that occurred in the New Zealand economy, public sector, and many areas of policy, health, housing, and the environment in the 1980s and early 1990s. In essence, we had a major reform period of about nine years—from 1984 to 1993. This fell into two categories: first, those reforms introduced by the fourth Labour government from 1984 to 1990; second, the reforms introduced by the fourth National government from 1990 to 1993.

Since then we have not experienced reforms of a similar magnitude. We have had minor reforms, but they have been of an incremental and sporadic nature. Of course, the fact these recent reforms can even be compared with those of the nine-year period is a testament to the longevity of that initial wave of reforms. Indeed, if the success of a reform is measured by its sustainability, one would have to say the New Zealand reforms have been largely successful. For the most part, they have been sustained over the course of several different governments, of different political persuasions.

In terms of the actual reforms, obviously there was a range of economic reforms that took the form of macro and micro changes. In essence they were about economic liberalisation, covering virtually every area of economic policy: trade policy, industry policy, competition policy, labour policy, tax policy, capital markets, major fiscal consolidation, monetary-policy reform, and so forth.

And it was in that context of radical economic liberalisation that we had a remarkable period of public-sector management reform. The significant legislative changes of that period included: the *State Owned Enterprises Act* of 1987, the *State Sector Act* of 1988, the *Public Finance Act 1989*, and then the *Fiscal Responsibility Act* of 1994.

As pieces of legislation, these acts anchored in place the reforms. Further, they radically changed the nature of our public sector in New Zealand in terms of our financial-management systems, human-resource management systems, the structures of our institutions and the accountability framework. We underwent a significant process of corporatisation, commercialisation, privatisation and contestability.

And in very broad terms, the key features of these new public-management changes included the remarkable speed with which they were introduced, the radical nature of some of the changes by the standards of New Zealand at the time, and, by international standards, the comprehensive nature of the changes. Nor were these one-off changes. They were part of a 'job lot', in the phrase used earlier by the former Australian Minister of Finance Lindsay Tanner. They were also relatively coherent. They followed a particular paradigm or ideological framework, being largely market orientated and liberal by nature.

But how were these changes made possible? Changes of these kinds rarely occur in democratic regimes internationally. How then was it possible to introduce these sweeping economic and public-sector reforms, and to do it so quickly, and effectively, and in a sustained manner? An explanation can be found in the work of John Kingdon, and his idea that in thinking about reforms we need to think in terms of three streams of activity: problems, solutions, and politics. In essence, during the period of radical reform beginning in 1984, these three streams came together in a rather unique way.

First of all, New Zealand was provided with a window of opportunity. This came about by an exchange-rate crisis in the middle of 1984 associated with the election, coupled with protracted economic difficulties—decades of economic decline creating a window of opportunity for people who were prepared to seize that window. In a sense, it was no longer possible to continue pursuing this approach. Something had to change.

Second, we had some ready-made solutions. For at least a decade, the Treasury had been planning ways to transform the New Zealand economy. As part of this process, they had prepared a series of thoughtful papers, and indeed at the time of the 1984 election, had produced a book advocating significant reform called *Economic Management*. Subsequently, at the 1987 election, a second book, called *Government Management*, was launched. So there were ready-made solutions to complement the work that the political parties were doing—not least Roger Douglas in the Labour Party.

The political stream emerged when the Labour Party came to power in 1984, thus completing Kingdon's trifecta. This new government contained an energised ministry of people who were prepared to take risks, and who were prepared to

provide leadership. Had the government not had that willingness to take risks and the leadership capabilities of the people at that time, these sorts of changes would not have been possible.

But there is one other element that is critical to understanding the reform process in New Zealand, and that is the constitutional framework. Unlike the federation of Australia, New Zealand is a unitary state, making for a much simpler political system. Moreover, we have a unicameral parliament, so there is no Senate to block or divert reforms. Again, that is critical. And at that particular time we had first-past-the-post voting, enabling changes to be made quickly if you had a determined government with a clear majority in Parliament. Those conditions obviously do not apply in Australia, and they do not apply in most other democracies—or at least not to the same degree.

What about the results? Well, critically it would be fair to say in terms of the economic outcomes they have been mixed. While the economic reforms produced the positive outcomes of low inflation, a fiscal surplus from 1994 through to 2008, substantially reduced public debt and reduced unemployment, only relatively modest economic growth was to follow, at least in terms of gross domestic product (GDP) per capita.

The real wage gap with Australia has continued to widen, particularly in the past couple of years, and accordingly New Zealand faces the continuing problems of being a relatively poor neighbour to Australia. Why, then, were the economic reforms not more successful? That is probably the subject of another chapter, but there are a number of reasons, some of which will be discussed later in this chapter.

What about the state-sector reforms? From the evidence I have seen, and that I have been involved in helping to generate, it would appear these reforms were successful at least to some degree, if not to a significant degree. Evidence of improved efficiency, effectiveness and profitability of our state-owned enterprises certainly occurred. Moreover, New Zealand continues to boast a low-corruption and high-trust environment for its citizens and businesses. Evidence from the two-yearly Kiwis Count survey suggests the services provided by the public sector are generally regarded as satisfactory, if not of good quality, by the consumers of those services.

And there has been relatively little pressure to revisit the fundamental features of the new public-sector regime. That is not to say there are not problems with it, but there is not huge pressure to reconfigure the regime. Together, this suggests that the reforms have been relatively successful.

There is, however, one unintended result of the new public-management reforms of that period of which we should not lose sight. Because of the huge public

dissatisfaction with some of the ways in which these reforms were introduced, and some of the early consequences, we ended up with constitutional change. As a result of a series of referenda, we moved from a first-past-the-post majoritarian system to a mixed-member proportional system, otherwise known as proportional representation. This ramification was clearly not intended, and it has created an environment in which the reforms that were introduced during that period of 1984–93 could not be rolled out with such speed today. There is an irony in all this. Recently, we have seen evidence of this loss of reformist capacity over climate-change policy. Any reform proposal is now complicated by the system of proportional representation we have adopted.

Finally, let me identify five brief lessons from this reform experience. First, we could say the reform of some of the sectors of the New Zealand public sector has been more easily achieved than in others. Reforming the health sector has been particularly difficult, but also reforms in education, welfare, and environmental management have been much more difficult than in some other areas. And it is not difficult to understand why. Partly it is because of the inherent complexity of these issues, and partly it is because of the powerful interests that are at stake. It has also been because of a lack of leadership and vision.

Second, we have had far too much emphasis in New Zealand on machinery-of-government changes, which has been both costly and disruptive. Further, continual restructuring has tended to remain a feature. One of the drivers has been a situation whereby because chief executives have a significant amount of autonomy, they have the capacity to undertake reform. Consequently, when a new chief executive is appointed, you can almost guarantee that within six months there will have been a restructuring of the department. This restructuring fetish associated with the particular incentive structure in relation to chief executives has been one of the unfortunate aspects of our reform program.

Third, we have not given enough attention to the problem of size. We are a country of 4.3 million people trying to do everything that a country of 20 million does, or even one of 200 million. And that creates some very significant tensions, not least because we are essentially a second-world economy, rather than a first-world economy. How we address that, I do not know, but there are some interesting questions here that are relevant to the states in Australia.

My fourth lesson is that the reforms placed unduly high expectations on ministers, as the authorising agents, the principals and purchasers of services. The model we developed assumed that ministers would be competent and discerning purchasers, and, moreover, that they would be willing to specify their desired outcomes clearly. While I am not meaning to suggest that all ministers are incompetent or lacking in discernment, we can be reasonably confident of the fact—from 20 years of experience—that very few ministers are prepared to

specify their desired outcomes with a high degree of specificity. And without that we have a fundamental flaw in our public-management system, which is predicated on the specification of outcomes, leading to the purchase of outputs, and then a purchase of inputs to achieve those outputs, all with the objective of achieving the desired outcomes.

And finally, through these reforms, we have created in New Zealand a public sector that is relatively risk adverse. There are a number of reasons for that, and I am not sure what the solutions are, but we have created a disincentive structure that actually tends to reduce the willingness of the public sector to provide the kind of leadership it did 25 years ago when Sir Roger Douglas became a minister.

Embracing the politics: the lessons from 'Rogernomics'

Sir Roger Douglas

In the remainder of the chapter, I will reflect on my experience as a principal architect of the reforms in question, but first I will elaborate on the aforementioned point about the comprehensive nature of our reforms. It is my firm view that if we are going to undertake reform, unless we aim to undertake it in a comprehensive way then it is probably not worth doing in the first place. If we are simply going to fiddle around the edges, or do ad-hoc reform, we are probably better to leave it alone, because the cost of what we are implementing is probably equal to any benefit we would get from the changes. There is no point, for example, reforming the financial-market area, if we leave the goods market, or the labour market, and the public sector itself, alone. So, reform needs to be done in a comprehensive way.

Turning to the politics of major reforms, this is of vital interest to the politician as opposed to the occasional commentator. Reforms start with the politicians. In fact, we often need a group of politicians who are prepared to lose, because often undertaking reform might be unpopular, or it might take a while to engender benefits for the public. So politicians need to ask the question 'why am I in politics?' And if it is because you want to be in perpetual power, you are not going to champion reform. And if you really want to achieve something then get on with the job.

Looking around the world (and certainly in New Zealand at the moment), most politicians ask themselves the wrong question. That question is: 'what can I get away with; what will the public accept?' And when a politician asks that question and designs a program accordingly, we will always get the wrong

answer. The question politicians need to ask is: 'what should I do in the interest of the country?' And then one might ask a second question: 'how do I market that particular policy to the public?' It is at that point that some adjustments might be made.

I agree with the point made earlier by Jonathan Boston about ministers acting as purchasers, and authorising agreements with their departments covering the required outputs for the year. Most ministers simply sign what the department puts up to them. I always had the view—and it was one that I was pushing well before I got offside with the Prime Minister and left the ministry—that ministers need two or three outside advisors in order to be sure that they can clarify exactly what are their goals and priorities.

When I was Finance Minister, what we in Treasury did was quite simple. We listed under various headings or sets of activities the issues that were likely to come up, or that we wanted to come up. Then we would put in the next column what our approach to this issue was in the interest of the country. We then asked if we were to develop policy along those lines, how long would it take—usually how many years. We then tried to estimate the benefits for the nation. We then said: 'how do we market these ideas within the government and to the public?' And that determined our work program, but because there were always a lot more things on the list that we wanted to do we had to establish priorities. For example, port reform was considered to increase GDP by 1–2 per cent. We estimated what chance we had of getting it through, which we said to be 20 per cent. In the end, we actually did get it through.

Looking back at the New Zealand experience, wherever we introduced what I call quality policy, the policies lasted. Wherever we went for reform and went for the best options, and were prepared to take the heat upfront, those policies are still in existence today and are not the subject of much popular comment. Contrastingly, where we undertook less than optimal reform, such as in education, health and welfare, the problems still exist to this day. They are still on the agenda, and they will not be solved until we go for a more radical policy.

Strong leadership is required for reform not just in the political sphere, but also within the public sector. Yet consensus and support for major reform are unlikely to occur until it is actually implemented. Consensus comes when you make a decision, you implement it, and it actually works, and then people agree with you. In my case, if I had gone along to the trade union representing forestry workers and said to them 'we are going to reform you; you currently have 7000 members and on 1 April you will only have 2700', it is highly unlikely they would have agreed.

Therefore, one of the key factors behind our success in implementing our reforms is that we packaged the changes, and we aimed for quantum leaps. For example, we removed all the subsidies to farmers. They were getting approximately one-third of their income via the government in one form or another, and we eliminated virtually all the subsidies over a couple of years. But this would have been impossible to do had we not at the same time had microeconomic reform in terms of eliminating import licensing and lowering tariffs, so their inputs were cheaper, as well as reform of transport and the ports so the cost of getting their products across the wharf was halved.

So there was a package, and that was absolutely fundamental. Whilst some people lost their privileges, they actually gained from the fact that everyone else lost their privileges as well. And overall these people were probably better off because government was no longer the middleman.

I can well remember a meeting with a range of interest groups after my first budget. They had come to the view that our radical reforms were in the interests of the country, and therefore in their long-term interest—all, that is, except the road-transport operators, who thought that putting up their road-user charges by 48 per cent in one hit was excessive, but they were howled down. We did that because we wanted to end some of the monopoly rights the railways had. Hence, packaging reforms is absolutely vital to their success.

Further, speed is absolutely essential in any program of reform. Many people say that our program in New Zealand was implemented too quickly; I do not think we went fast enough. It is not too much speed that kills reform but rather uncertainty. The times when our government found itself in trouble were due to uncertainty. For instance, we were persuaded by the States Services Commission shortly before an election to visit and consult on the West Coast of the South Island. We were reforming the coalmines, causing them to lose half their staff, and the forestry sector, which lost two-thirds overnight. These were big employers on the West Coast, one of New Zealand's poorer areas. So we went down there to consult, leaving the affected families in limbo for three or four months. No-one knew if they had a future job or whether they would receive a generous redundancy payout. During this period, we went down to being 5 or 6 per cent behind in the opinion polls. Many people in cabinet were nervous about pushing on with such reforms, but we decided to go ahead. A month later, we were 15 per cent ahead in the polls again; what damaged us at the time was uncertainty, not the speed of the program.

But to act quickly we have to be sure of the reform principles and to have done the work program. Governments have only a limited time frame or window of opportunity. So if governments are thinking about a political time frame, they

need to get their programs launched in order to see some benefits down the track. If they drift for too long then the motivation disappears. If we had not taken decisive action in 1984 then the consensus we built would have evaporated.

Another important lesson to remember is that in the midst of a major reform program the reformers should not allow themselves to blink. Everyone will come initially and want the decision makers to change their minds, but if they give any impression that they might then all the opponents' efforts will be focused on getting a change of mind. If, however, they think the reformers do not intend to change then they go away and get on with their own jobs. And we should remember that unless they get on with their jobs, we are not going to get any benefits, because it is not the politicians who create the real benefits it is those producers who change the way they do things.

Consultation is also important and it is important not to sell the public short. We should be upfront; we must tell the public what we are trying to achieve and why our approach is better than others. But we should consult against decisions that have broadly been made. We undertook a major round of consultation when we introduced a goods and services tax (GST), but the people who did that for us went out and consulted. They knew we had made a decision to adopt the GST; they were helping us work out how to do it in the best way.

If we are introducing substantial change, we should not be afraid to tell people the downside. If governments sell only the good side, they will not succeed. If there is going to be a downside—such as half the people in a particular industry losing their job—there is no point not communicating that. We must tell short-term losers why the reform is of benefit to the nation and ultimately of some benefit to them. It is also very important to tell the public about the reform program as far in advance as possible, because there are individuals and businesses out there who have to make the necessary adjustments. For example, when we undertook tariff reform, we announced a program for three or four years so that businesses actually knew the end point. There was no point announcing, say, a reduction in tariffs of 10 per cent if ultimately we were going to take 30 per cent off them. They needed to know. Some businesses might say they could live with a 10 per cent cut, but if they knew it was going to be 30 per cent in three to four years they would then decide on their business strategies. Maybe they would get out of certain lines, or import those lines, or concentrate on manufacturing a smaller range of products. So, the more notice we can give of our intentions, the better.

Where we did not succeed and what to do about it now

Some of our reforms failed or we ran out of time to pursue them properly. As in Australia and the United Kingdom, in New Zealand, the problems in health, education and welfare are yet to be adequately addressed. Over the past 20 years in New Zealand, we have thrown billions of dollars at these areas, and yet performance has not improved. In fact, productivity in health (after rising in the mid to late 1990s) over recent years has now dropped dramatically. Nor can anyone in New Zealand be happy with the outcomes of education, where 20 per cent of our kids come out of school unable to read, unable to do simple mathematics, and up to 40 per cent are not adequately prepared for today's world. Clearly, if other industries had such poor performance, they simply would not survive.

The problem is that over time politicians have created a rod for our own backs. We have arrived at a position where the actual institutional means of delivery—public hospitals, public education and public schools—have become the objective and the goal, rather than quality health care, an operation for anyone who needs one within a reasonable time, and a quality education for every child.

Moreover, if reformers decide to make some efficiency change, they are labelled as delivering a loss of equity, when in fact the truth is that we cannot have increased equity without improved efficiency. It is not a question of equity *or* efficiency. It is simply that we cannot have improved equity without improved efficiency.

So, what would I do about it now? The solution is relatively simple. We must open up the supply side; we must provide consumer choice, introduce competition, and get rid of the monopoly aspects of provision. For instance, I would provide the people of New Zealand with the existing option of staying within an education system that fails 20–40 per cent of the people it serves, but also provide new options, such as different incentives to parents. We might allow parents to receive the first \$35 000 of their income tax free if they choose to opt out of the public system, putting an extra \$6000 or \$7000 in their pocket to invest in their choice of schooling and health cover. The same could apply for sickness or accident cover or unemployment insurance. But if we elected to do such things then two things would have to be ensured. First, people would have to subscribe to an educational provider for schooling, and would need to buy an approved health cover, and accident, sickness and unemployment insurance. Some of these insurances would be subsidised by employers—at least the accident and sickness parts. We would also encourage people to save

so that they would have sufficient savings to look after themselves in retirement and in aged health care as well. Those already nearing retirement would not have time to build up their savings, so might need a percentage of the current pension to enable them to subsist.

If we undertook such reforms, we would transfer some 30 per cent of the economy—which is now largely delivered in New Zealand in a monopoly way—into a competitive model. I do not personally care whether it is the public service that provides it, or the private sector; I simply want quality services such as kids being able to learn. I want choice. If the new competitive schools do not work, they go broke, and someone else takes them over or offers the services.

Paradoxically, the key ingredient in being able to deliver such competitive services is some form of collective property. To undertake this reform, I would put all the schools—primary schools and secondary schools—into a single property company. We would next create a board charged with ensuring that competition took place. The fixed infrastructure would be maintained but choice of delivery providers would be given to parents as to where to send the child.

If we did that in New Zealand, we would see the same improvements in productivity that we saw in forestry, coal, telecommunications and the postal system in the 1980s and 1990s. In some of those cases, we saw productivity improvements of 100 per cent, and where real prices dropped by as much as 50 per cent. If it can be done in these areas, it can be done in the health and education sectors as well. But it cannot be achieved under the current bureaucratic system that we have in New Zealand.