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New Zealand's Fiscal Responsibility Act

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The Fiscal Responsibility Act passed by the New Zealand parliament in June 1994 makes the government and the Treasury responsible for reporting to parliament specified information about fiscal strategy, the current economic and fiscal situation and the outlook over the medium and long terms. It specifies principles of fiscal policy that the government is to consider, but not necessarily to implement, when developing its budgets. The Act's supporters aim to tilt the balance of fiscal decision-making away from the short-term economic and political considerations that have been influential in the past and towards strategic and long-term fiscal objectives.

Outline of the Act

The Act provides for regular and explicit fiscal reporting; for parliamentary review of fiscal reports; for a set of benchmarks against which fiscal policies can be assessed; and for more open budgetary processes.

In operation, the Act endeavours to establish ownership of a broad fiscal strategy within the government with the oversight of parliament. It does this by requiring the government to develop an annual Budget Policy Statement and to present it to the parliament three months before the deadline for the budget. In this report the government presents its intentions for the main fiscal variables for both the coming budget and for the longer term and by reference to the principles of fiscal policy specified in the Act. It thereby sets the parameters of the forthcoming budget debate. This is intended to promote more informed trade-offs of strategic fiscal objectives by separating debate about them, at least temporarily, from the crush of detailed fiscal compromises and decisions in the final run-up to the budget. This is backed by requirements for full disclosure of information and for a Fiscal Strategy Report at the time of the budget, which compares the actual economic and fiscal information and decisions with the intentions laid out in the earlier statement and also with projections of the longer-term implications of current policies up to ten years ahead. The parliament is subsequently given regular economic and fiscal updates, and there is provision for special reporting in the period before an election. The Budget Policy Statement, the Fiscal Strategy Report, and the economic and fiscal update tabled at the time of the budget are to be referred for scrutiny to parliament's Finance and Expenditure Committee.

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Each economic and fiscal update is accompanied by statements of responsibility signed by the Minister of Finance and the Secretary to the Treasury attesting respectively that all policy decisions or circumstances with material economic and fiscal implications known to the government have been communicated to the Treasury and have been included.

Development and Passage of the Act

The Act's sponsor was Ruth Richardson, then Minister of Finance, who introduced it to the parliament in September 1993. Following the National government's near defeat in an election in November 1993, Richardson returned to the backbench and from there became chairperson of the Finance and Expenditure Committee that oversaw the development of the Bill.

She promoted the legislation in response to New Zealand's history of difficulties with fiscal policy, processes, information and outcomes. There was also some concern that the arrival of coalition governments after the introduction of mixed member proportional (MMP) representation might further complicate fiscal decision-making. Richardson believed that the build-up of government debt since the early 1980s raised a moral issue in that the political system was being used to pass a tax burden on to future generations who were underrepresented by today's politicians (the first balance sheet for the New Zealand government drawn up under its reformed Public Finance Act showed a negative net worth of NZ$14 billion). As Minister of Finance, she had experienced the difficulties of trying to keep a cabinet focused on strategic fiscal objectives rather than becoming lost in short-term decision-making portfolio by portfolio. Her advisers in the Treasury had acquired first-hand experience of this problem; as well, they had studied equivalent practice and reactions to it in other countries, notably the UK, Australia and the US, which suggested the importance of stable and open budgetary processes with a medium-term framework.

Politically, the Bill's development was stimulated by concern about the fiscal information available to the public during an election campaign. In 1990, as in 1984, an incoming government claimed, correctly, that the fiscal situation was much worse than it had been led to believe. The insolvency of the Bank of New Zealand (BNZ), which was known to the government but not to the opposition, prompted the Ombudsman to assert that the fiscal situation in the run-up to the 1990 election should have been more transparent than it was. In reality, it would be impossible in any circumstances to disclose that a government financial institution was on the edge of bankruptcy without simultaneously announcing the solution to the problem. But any such solution would require the agreement of the opposition: which would be all but impossible to negotiate between political opponents in the middle of an election campaign that the opposition was likely to win. The BNZ issue did, however, focus attention on the wider issue of the desirability of full fiscal and financial information being available on the eve of an election.

Several questions arose in the debate before the Finance and Expenditure Committee and in the parliament. Can parliament bind or seriously influence future governments on such matters as running fiscal surpluses? Should debt be expressed in nominal amounts or as a ratio to gross domestic product (GDP)? Are the principles of fiscal policy in the Act sufficiently clearly expressed to exert any real influence? Is a government less likely to depart from the Act's fiscal policy principles because it has to give public reasons for doing so? How would the effects of fiscal policies on social equity, growth and employment be taken into account?

The provisions of the Bill that promoted full information, more informed debate and more stable and open budget processes attracted bipartisan support (the Labour Party members of the Finance and Expenditure Committee included some ex-ministers who had experienced New Zealand's fiscal stresses at first hand). The majority of the committee preferred to embody principles of responsible fiscal management in guidelines rather than mandatory targets on the grounds that such guidelines

- 'state explicitly what the characteristics of responsible fiscal management are;
- encourage a medium to long term perspective in the conduct of policy;
- can provide a mechanism to allow for shor term cyclical fluctuations; and
- recognise that governments may have to depart from the guidelines or their objectives but require any departure to be justified and thus transparent.' (Finance and Expenditure Committee, 1994)

The Labour opposition did not, however, support the inclusion of principles for 'responsible' fiscal management. But the Minister of Finance, Bill Birch, accepted the majority recommendation and proposed five principles expressed in the Act as follows:

- 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 risks facing the Crown; and
- the pursuit of policies consistent with a reasonable degree of predictability about the level and stability of tax rates for future years.

Any departure from the above five principles must be both transparent and temporary.

The Public Finance Act was amended in order to support the intentions of the Fiscal Responsibility Act by extending the coverage of its basic concepts, such as the Generally Accepted Accounting Principles and output-based appropriations and financial management across the whole of government. The result is that the financial implications of government decisions are highly visible: for example, an appropriation is required when the government disposes of an asset below its recorded book value.

The Act raises several basic questions. Has New Zealand's fiscal policy been poor, and is it likely to be in the future? Have institutional biases towards poor fiscal policy arisen from budget processes, the government's financial management regimes or the structures of parliament and the incentives on its members? Can the Fiscal Responsibility Act correct any such institutional weaknesses?

New Zealand's Fiscal Record

While the fiscal situation is satisfactory today, it has displayed difficulties, that were sometimes serious, for most of the last 20 years, and all of the last ten. The government's fiscal advisers in the Treasury repeatedly emphasised this, as is evident from the series of briefing papers presented to incoming governments after each election (Treasury, 1984, 1987, 1990, 1993). In 1984, the IMF described the fiscal deficit, which was rising to about 9 per cent of GDP, as 'a major imbalance in the economy that had become more serious [and] threatened to have a severe destabilising effect on the economy' (cited in Douglas & Callan, 1987).

This situation had developed over many years. Spending on goods and services and transfer payments, which had increased from 22 to 25 per cent of GDP between 1950 and 1974, rose to 38 per cent in the late 1980s. Real taxation per head more than doubled from the 1970s to the 1990s. The fiscal balance moved heavily into deficit at the end of the 1970s and remained there until recently. Real gross public debt per head in 1993 dollars rose over the same period from NZ$7,500 to nearly $14,000 by 1990. Net public debt rose from 40 per cent of GDP in 1984 to a peak of 51 per cent in 1992. This debt was not backed by productive assets owned by government; and its financial statements estimate that the net worth of government, which had turned negative probably in the early 1980s, was minus $7.7 billion in 1993. (These calculations ignore possible long-term increases in tax revenues and reduced social costs resulting from education and social policies.)

The ratio of debt service to government revenue reached about one fifth in the late 1980s. New Zealand's credit rating slipped over the decade from the early 1980s from AAA to AA; a single A rating was narrowly avoided in 1991 only because the incoming government after the 1990 election took decisive action to contain a deficit that was forecast to expand to 5 or 6 per cent of GDP.

Policy Design, Implementation and Coordination

New Zealand's fiscal policy has sometimes been poorly coordinated with other instruments of economic strategy: monetary policy in particular, but also regulatory policy and public-sector management. Fiscal policy has periodically been directed at objectives that were better approached by other policy instruments, and has not been sufficiently focused on medium-term macroeconomic objectives.

Macroeconomics. Structural fiscal problems were treated as if they were cyclical problems, and growth promoted through discretionary fiscal and monetary policy. Typically, the economy was stimulated in the run-up to an election, but not reined in afterwards to the same extent. As a result, it began successive fiscal cycles from a progressively worse position. Like other countries, New Zealand learned late that discretionary policy is ineffective in the presence of more fundamental structural problems and when a short-term stimulus is not sufficiently credible to evoke a strong response from the private sector. More generally, manipulating short-term fiscal policy to stabilise aggregate demand rather than directing it to longer-term objectives often turned out to be destabilising because of the way it was implemented and the coincidence of stimulatory action with the electoral cycle. Such policies were therefore sometimes pro-cyclical rather than counter-cyclical (see Deane & Smith, 1979.)

It is very difficult to disentangle by econometrics the impact of fiscal policy on other macroeconomic variables, particularly interest rates. But the government and its advisers became convinced that the fiscal situation was putting upward pressure on interest rates and exchange rates, so delaying the return to economic growth. These pressures were attributed not only to the deficits themselves but also to the lack of credibility in the financial market-place of the policies designed to eliminate them. If credible, a promise to cut the deficit can buy time to do so with less cost and disruption. If a promise is not credible, then short-term action is needed to establish credibility and to contain the country-risk premium that is built into interest rates. The Reserve Bank of New Zealand Act 1989, which set up an independent central bank with an explicit inflation target, had dramatically increased the credibility of monetary policy. But, in Ruth Richardson's words, 'monetary policy needed a mate' in the form of credible fiscal policy. This had been lost in 1990 due to cyclical, structural and political factors. But the fiscal corrections initiated in 1990 and emerging in the 1991 budget restored credibility: the decline in the credit rating was arrested, and interest rates and the exchange rate declined together, contributing to the economic recovery that began at that time.

Structural issues. New Zealand's fiscal policies suffered from structural weaknesses on both the taxation and expenditure sides. Tax reform, to replace a narrow tax base and variable rates with a broad base and low rates, was instituted to provide a more buoyant tax base with lower efficiency losses while continuing to meet some equity objectives. Key features of the approach included the goods and services tax, fringe benefits tax, imputation, elimination of tax expenditures, an international income-tax avoidance regime, timing rules and support for people on low incomes delivered through the tax system. On the expenditure side, the underlying frameworks of government intervention were reformed in order to correct fiscal imbalances while pursuing other policy objectives. These reforms were conceived in the mid-1980s, a time of serious fiscal problems that could not be fixed by traditional marginal adjustments to expenditure and revenue. Governments since have sought to improve the process of fiscal decision-making and the management of government organisations. The role of the state has also been reduced or redefined in many areas to reduce and redirect fiscal loadings. Specific programs to achieve this have concerned state enterprises, privatisation, structural reforms of government institutions and a results-based management system in core government administration.

Fiscal reporting and information. Information about fiscal policy and government finances was for a long time of poor quality, late or non-existent. As early as 1978, the Auditor-General was deeply critical of the government's financial management information systems, but was largely ignored. New Zealand learnt to its cost the dangers of cash-based accounting systems that did not reveal the extent of deterioration in the government's net worth or the huge contingent liabilities that came to charge on a large number of government sponsored energy-based investments that crashed in the mid-1980s.

Intergenerational transfers of wealth and taxes. In common with many other countries, New Zealand had come to realise through the 1970s and 1980s that some of its fiscal difficulties had a long-term dimension. Leading politicians on both sides of parliament were acutely aware of the difficulty of pruning an unaffordable government superannuation scheme that had been introduced hastily in 1975 and promised every citizen 80 per cent of the average post-tax weekly wage from the age of 60. The aging of the population was turning this program into a fiscal time-bomb with a very long fuse and bringing about an inequitable redistribution of income towards the elderly. It was one element in a pattern of distribution causing growing concern that the welfare state had arguably cared for the older generations throughout their lives but was now leaving younger generations with less support (Thomson, 1991).

The Current Fiscal Situation

In late 1991 the economy began to recover from recession and the fiscal deficit subsequently began to improve as a result of cyclical influences and the effects of policy changes and compression of administrative budgets. By the latter part of 1994 the fiscal situation had turned around. The ratio of government expenditure to GDP, which had peaked in 1991/92 at 44 per cent, had fallen to 35 per cent. The government was running the first fiscal surplus for 17 years. The net worth in the government balance sheet was still negative at about NZ$6 billion, but expected to turn positive within three years. The growing credibility in fiscal policy was among the influences that had resulted in the country-risk premium in interest rates falling from roughly 4 per cent to 2 per cent at the trough (though it had risen a little due to political uncertainty and other factors). The OECD had, some years earlier described New Zealand's tax system as 'the least distortionary of its member countries'.

Will the Act Address Past or Prospective Institutional Weaknesses?

Although the fiscal situation and prospects have very greatly improved since the economic recovery began in late 1991, New Zealand has clearly suffered very considerable fiscal difficulties over a long period and, despite the present favourable trends, still has some distance to go. The record also suggests that many lessons must be learned if history is not to repeat itself.

The problems in fiscal policy noted above arose from several interacting causes:

- a lack of clear objectives;
- a short-term focus and lack of appreciation of the medium-term consequences of decisions;
- poor policy instrument assignment and coordination;
- poor information for decision-making and performance reporting;
- inertia and incrementalism in fiscal-policy decision-making; and
- lack of appreciation of the need to measure, anticipate and manage risks.

The recent improvement in New Zealand's fiscal situation was accomplished without the Fiscal Responsibility Act. But the Act codifies and extends some of the measures and policies that underlie that improvement. It is a logical addition to the reforms over recent years to fiscal policy and public-sector management in New Zealand, which themselves enhance the prospects of achieving the Act's objectives. The key questions about the Fiscal Responsibility Act are whether the institutions of fiscal policy have biases against desirable outcomes that help explain past problems, and, if so, whether the Act usefully addresses them.

The Act provides for better information and analysis, a stable reporting cycle, a greater focus in reporting on strategy, less secrecy about budget planning, more scrutiny by parliament and benchmarks for assessing fiscal policy. Important as these are, embodying them in law might not by itself make much difference, particularly if the government of the day is not committed to the goals of the Act. Such a government might, for example, comply in a perfunctory way with the requirements for budget reporting (though it would still be harder to avoid scrutiny than in the past; and the accounting standards, being beyond the control of the government, cannot be evaded). But in the context of the stream of fiscal reforms in recent years, and on the assumption that a future government, particularly its finance minister, is not determined to evade it, the Act can make a significant contribution.

A wide perspective of fiscal policy takes account of the complexities of real-world decision-making, the information and incentives on the many parties involved, inadequacies in political representation of the wider public interest, externalities, public goods and the strengths and weaknesses of various institutional arrangements in biasing the whole system towards good or bad fiscal outcomes. These issues are largely missing from conventional models of fiscal policy, which often imply that fiscal settings are made by omnipotent beings motivated solely by the public interest and operating with high-quality, if not perfect, information and with little or no uncertainty about either the future or the effects of policy interventions.

Some of the ideas from the institutional economics literature concerning fiscal policy emerged in the submissions on the Fiscal Responsibility Act. The New Zealand Business Roundtable (1994) noted some of the theoretical reasons why democratic processes might have biases towards outcomes that are not in accord with the voters' interests or may be inefficient in serving them. Voting procedures can fail to reveal underlying preferences. Politicians are likely to concede to expenditure demands from groups of voters when their benefits are highly concentrated but their costs widely spread. This also occurs where the self-interest of politicians and bureaucrats in the expenditure programs themselves impinge on the decision processes. Pressure for excessive deficits can also arise where those who will bear the costs (in particular, future generations of taxpayers) are under-represented in the political process. Information on major choices is poor; in particular, voters do not know the deadweight losses imposed by taxation.

The philosophy behind the Act is to provide a counterweight to such biases by providing for at least an informed debate over medium-term fiscal strategy objectives and, preferably, ownership of objectives that are in some measure of harmony with specified guidelines. This need not mean the subordination of careful detailed decision-making about fiscal programs and their management to general macroeconomic imperatives (experience shows that such attempts fail anyway). It does, however, favour prior political agreements and understandings about broad fiscal goals and the need to embody them in tight managerial processes that coordinate the extensive machinery of fiscal decision-making in a way that effectively imposes strategic priorities on the whole system. The objective should be to integrate macro and micro approaches to get both well-designed and effective programs as well as macroeconomic policy that contributes to wider development goals. In terms of conventional principles of public finance theory, the objective of fiscal decision-making is to equate the contribution to welfare of the last dollar of public expenditure with the cost to welfare of the last dollar of taxation raised. The challenge for practitioners is to design institutions that enhance knowledge of the costs and benefits of fiscal interventions and so help us make decisions that move us closer to the ideal balance. The Act should contribute to such an improvement.

New Zealand's budget system was beset by untidy and changing processes through stresses in the 1980s that harmed fiscal outcomes. In contrast, Australian federal budgetary systems at the time were characterised by tightness and stability. New Zealand adopted some Australian innovations, such as the use of baseline forecasts from the previous year to initiate the preparation of the current budget. New Zealand's budgetary processes have improved steadily and are today good by OECD standards. Some of the management and reporting innovations are on the frontier of international developments. Yet institutional biases towards poor fiscal policy have contributed significantly to difficult fiscal outcomes. Many of these problems have been addressed; the Fiscal Responsibility Act has the potential to make a contribution to further improvements in some areas.

The long-term forecasts and scenarios that the Act calls for are intended to expose the out-year effects of current decisions. The Act properly requires publication of the key macroeconomic variables that heavily influence any fiscal forecast and are vital for the proper appraisal of forecasts. Whatever their degree of accuracy, these out-year forecasts have sometimes been critical to assessing the need for fiscal correction; and governments' occasional past reluctance to publish them suggests their significance. The developments proposed in the Act and included for the first time in last year's budget are an important advance.

Long-term Projections

It may take some time for people to learn to evaluate the information content in long-term projections. Though not forecasts, some commentators will inevitably treat them as such and try to embarrass the government when events stray far from them. The projections are a way of expressing the implications of certain decisions whose effects are long lasting and/or involve policies that take a very long time to change or involve long-term contractual commitments between government and citizens.

Attention to the long-term implications of the current fiscal stance also raises the issue of long-term sustainability. While there is ample scope for a government or a succession of governments to make adjustments to fiscal policy over a five- or ten-year period, some large areas of expenditure involve entitlements that cannot be changed without serious disruption when problems arise. People are entitled to make plans in the expectation of stability of those aspects of fiscal policy that have a major impact on their standard of living and life-cycle. Similarly, businesses that have made or are considering making long-term investments in New Zealand will be discouraged by unpredictable and rapid changes in those of their key costs that are determined by the government.

Those elements of fiscal policy that involve the government in long-term commitments should be planned in a long-term framework that requires attention to long-term fiscal scenarios. This applies to the linkage between fiscal policy and demographic change in the population structure. Lack of long-term planning in these areas could precipitate arbitrary intergenerational transfers of income and wealth: a particularly serious issue in current thinking about long-term fiscal policy.

Emphasis on long-term projections and other elements of transparency (including, in particular, the government's unique financial statements) will help to indicate the extent to which the tax burden is being shifted into the future.

Improved Information

The Act links the information systems for budgeting with those of reporting the government's finances. This simple idea is used everywhere, from tennis clubs to the largest corporations. Governments, however, tend to focus on their plans at the expense of outcomes. The sections modifying the Public Finance Act in order to apply accrual accounting to payments to third parties on behalf of the government is a long-planned step in the evolution of the government's financial management.

The clauses that require full disclosure of the government's information about the fiscal outlook are critically important to the whole scheme and should remove a major source of public dissatisfaction about nasty surprises that were, or should have been, known to the government.

The clauses requiring pre-election fiscal information will at times raise tensions in the relationships between the government and its advisers. But New Zealand's experience suggests that these are manageable and should be a source of increased stability and realism in the development of fiscal promises by parties seeking power.

The reliance on the Generally Accepted Accounting Principles is almost unique internationally and highly desirable. It does, however, require New Zealand's public-sector accounting standards to be continuously researched, developed and upgraded by the active participation of public-sector accountants in the Accountants' Society, and endorsed by the Accounting Standards Review Board established in the Financial Reporting Act. The Finance and Expenditure Committee of parliament should satisfy itself periodically that these standards are being developed satisfactorily and are addressing topical issues. Although the requirements for accounting standards are generally the same for both public and private sectors, the public sector raises some unique accounting issues that must be dealt with on their own terms rather than through the careless adoption of conventions from the private sector or other countries.

The Act makes important advances in establishing the financial responsibilities of departmental chief executives and linking their financial plans tightly to their appropriations. Any slippage between these two could eventually impair the usefulness of the estimates to parliament as a management document.

Targets and Guidelines

American experience suggests that fixed targets are not politically durable and are evaded. This and other international experience influenced the Finance and Expenditure Committee's deliberations. Labour parliamentarians opposed inserting principles in the Act on the grounds that future governments could not be bound and that forecasting errors could, in conjunction with the let-out provisions, be so large as to render the degree of consistency between budget and principles very uncertain.

The point about uncertainty is valid. But the question remains as to whether the statement of fiscal principles can have political durability and remain influential in fiscal debate. The Act leaves the government with a wide range of discretion in being able to persuade the parliament of the day that its decisions are in the country's long-term interests. There will always be debate about whether fiscal policy is too tight, too loose, or just right. This could not have been resolved by the setting of mandatory targets, which is neither technically desirable nor politically feasible. It would create incentives to window-dress fiscal policy by concealing information and moving policies off-budget.

It should prove beneficial to require fiscal policy to be assessed in relation to criteria that, although general, have been approved by a majority of the parliament. This will strengthen the Minister of Finance and others negotiating a budget in the face of pressure from sectional fiscal interests that ignore the larger picture. It is inevitable and desirable that debate will continue about what the principles mean in changing circumstances. Over time, norms and technical details will become established. Parliament will still be free to ignore the criteria but, where adverse trends are clear in the figures, will do so in the face of information suggesting that the fiscal policy is not sustainable. Many members of parliament would not do this lightly.

The criteria established by the Act are well chosen. The credit rating was excluded from the Act; but it will inevitably be a point of focus in the debate about managing risks in the government's balance sheet. Any well-designed medium-term fiscal strategy will give consideration to debt ratios and the debt-servicing capacity of the economy, the vulnerability of the economy to adverse shocks if the government's plans for economic growth are not realised for either domestic or international reasons, and the implications of today's decisions for future tax rates. Any government with substantial debts that was not giving consideration to these could be suspected of being sanguine about inflating the debt and interest away or rescheduling it.

It is impossible to place the criteria for sound fiscal policy beyond argument; and the Act does not try to do so. In the debate over the Act, the economist Bryan Philpott (1994) argued against the use of the Generally Accepted Accounting Principles in reporting the government's position. His concerns relate to the distinction between consumption and transfers, capital as opposed to current expenditures, and externalities arising from government expenditure on, for example, infrastructure and education. He argued that social rates of return must feature in government accounts or, more particularly, in policy-making. He and others were concerned that the Act would inhibit the government from implementing countercyclical fiscal policy to regulate aggregate demand. But although these considerations should be accounted for in setting medium-term strategy and any particular annual budget, the reality is that a government that does not take the initiative in ensuring that its financial position is sustainable is more likely to have the adjustment imposed on it from the outside with far greater costs to its citizens. The principles in the Act require information to be provided bearing on the sustainability of the financial position.

In addition to the principles, other issues will have to be accounted for, such as the separation of cyclical and structural elements of a deficit, the risks surrounding fiscal and economic forecasts, and the risks within the balance sheet arising from volatility in exchange rates, interest rates, cash flows and equity values in state-owned enterprises.

Given that no single measure of fiscal stance is completely reliable, the question arises as to the weights that parliament will attribute to the different criteria. Financial markets will apply the criteria in judging the budget after they see it. But politicians have constituents to worry about other than those from whom the government borrows, and they might be more likely to take advice from an organisation of their own creation. The government's analytical resources for passing such judgments lie in the Treasury, for whom this is a natural part of any suite of budget advice. Parliament will want to question Treasury on that advice, and can then form its own judgment of the analysis. This could lead to tensions between the department and the Minister of Finance if their judgments differ, though experience in recent years suggests this is manageable. It is very important, however, that Treasury's political neutrality is preserved, even though it is required to give straight advice based on its professional judgments. (The Council of Trade Unions raised concerns in the Finance and Expenditure Committee over the possible politicisation of the Treasury.)

If parliament sought a view independent of the public service, some other organisation could be created for that purpose. But any such body would have to become deeply involved with the Treasury's forecasting and analyses in order to be able to make a well-founded judgment.

The Fiscal Responsibility Act vs the Reserve Bank of New Zealand Act

Ruth Richardson was influenced by the importance of credibility in policy settings following the implementation of the Reserve Bank of New Zealand Act 1989, which she had strongly supported from the opposition benches when it was promoted by the Labour government. This Act made the central bank independent by means of a contract that specifies the government's inflation target and delegates to the Governor of the bank the responsibility for managing short-term interest rates to achieve this. The result has been a dramatic decline in inflation rates and much enhanced credibility for monetary policy. Richardson asked the Treasury for advice on how to impart similar credibility to the conduct of fiscal policy while recognising the fundamental differences between monetary and fiscal policies.

Although the experience of institutional reform to create a credible monetary policy formed part of the background to the debate over the Act, there is no substantial parallel whatsoever between New Zealand's monetary and fiscal policy reforms. It is reasonable to believe that the comparative advantage of monetary policy instruments lies in controlling the price level and that, although it has secondary influences on other policy objectives, these are better met by other policies that have comparative advantages in those areas. As well, it is reasonable to believe that the effects of monetary policy are felt with unpredictable time lags that are often so long that the policy is best conceived as having a medium-term horizon and requiring complex judgments to be made in the art of central banking. New Zealand's record of complete political control of day-to-day monetary policy was associated with high and unstable rates of inflation and very large costs to the taxpayers from underwriting exchange rates. Against this background it was thought wise to create a central bank that was insulated substantially from short-term political pressure and free to exercise its discretion about short-term interest rates while targeting a medium-term inflation rate that is set by the government. Fiscal decision-making, in contrast, goes to the very heart of a government's development strategy and political priorities, and cannot be delegated in the same way. Only the implementation of detailed fiscal decisions can be delegated.

The Prospects for Coalition Governments

In his study of the economic effects of MMP, Alan Bollard (1993) concludes that fiscal policy alone is likely to experience difficulties as a result of the new electoral system. The Minister of Finance will more than ever need institutional arrangements that enable fiscal strategy and policy to be developed and adhered to throughout the many months of decision-making that are involved in putting together a budget. It is quite impossible for a Minister of Finance to do this alone. New Zealand's most unsatisfactory budgets in recent years have all been associated with a lack of support for the Minister of Finance. New Zealand's experience, like that of Australia and the UK, demonstrates the importance of tight cabinet procedures in enforcing agreements about priorities and maintaining lines of strategy. The Act should be of some assistance to a Minister of Finance who wishes to structure a debate about medium-term fiscal strategic goals. But it remains to be seen how coalitions will go about forming fiscal policy.

Conclusion

Within the context of the wide-ranging reforms over ten years in fiscal policies, public-sector management, improved information and parliament itself, the Fiscal Responsibility Act should make a useful contribution to improving policy-making and offer some comfort for those who are concerned that one of the effects of MMP might be a return to deficits and increasing debt. The Act's information requirements entrench and enhance improvements since the late 1980s and should improve the chances of framing fiscal-policy debate over a longer-term horizon and with a concern for integrating sustainable fiscal policy within wider development strategies.

The Act's principles for responsible fiscal policy are likely to influence the debate; but uncertainty surrounding the forecasts and projections will complicate judgments over whether they are being observed, and the provisions for explaining departures mean they will not be binding. Yet this arrangement seems superior to excluding mention of fiscal principles from the Act or going for mandatory targets. Time will tell.

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