

WITH RUTH RICHARDSON, NEW ZEALAND FINANCE MINISTER, 1990-1993



**Ruth Richardson** has a well-known national and international profile. During the remarkable reform era in New Zealand from the mid-1980's to the mid-1990's, she established her reputation as an advocate for change. As New Zealand's Minister of Finance from 1990–1993, she was the principal architect of New Zealand's second wave of reform, complementing the first wave of reforms initiated in the mid 1980s by New Zealand's other well-known Minister of Finance, Sir Roger Douglas. Her institutional framework for the conduct of fiscal policy, the Fiscal Responsibility Act 1994, is widely regarded as setting international best practice, and is a cornerstone of New Zealand's economic framework. Ruth has established a substantial private sector practice in corporate governance and holds directorships throughout a wide spectrum of business activity on three continents. She was interviewed after her May 3<sup>rd</sup>, 2004 Frontier Centre speech on New Zealand's Fiscal Responsibility Act.

**Frontier Centre:** You are the Finance Minister who introduced New Zealand's Fiscal Responsibility Act. You have described that law as a parting gift to future generations. Before we discuss its merits or its effects, what does it say?

**Ruth Richardson:** It sets fiscal years with three features. It requires a high level of disclosure so you have open budgeting and no surprises prior to an election. It has quality disclosure because it has highly credible numbers because the budget is in accrual form and you have the whole suite of government financial expenditure. Its very principle lays down the characteristics of the conduct of good fiscal policy. The final feature to commend it is that it works because we have beaten debts and beaten deficits.

**FC:** Beyond their commonsensical virtues, how do the Act's key provisions for the reduction, stabilizing and hedging of debt, change the behaviour of elected officials?

**RR:** It raises the political and economic costs of economic irresponsibility because you have to publish and be damned so it changes the nature of the political debate. When you change the nature of the debate, you change the behaviour and you change the outcome.

**FC:** Why did you need to make changes in budget reporting, including the obligation for the production of key fiscal information?

**RR:** We needed a twin to our Reserve Bank Act of 1989 which set international best practice for central banks, for the operation, the independent and dedicated tool and the attainment of crisis stability. We needed to match that credibility with a similar code of practice, like a fiscal constitution on the fiscal policy side with standards. We are still missing one element from the trilogy. I would like a fiscal constitution that had independency for banks, codes of fiscal responsibility and codes of regulatory responsibility, so we have still got to score the third element.

**FC:** Why does the rule that mandates accrual accounting make a difference?

**RR:** Because you don't get the shocking numbers – you don't get the public sector equivalent of an Enron on your hands.

**FC:** You mentioned two changes that are needed to improve the Fiscal Responsibility Act. What are they and what weaknesses do they address?

**RR:** It was landmark legislation, the first out of the box as it were, as a code of fiscal responsibility. It has mandated fiscal rules but we have learnt something in ten years. The first is the quantitative issue – I think that there is an absolute limit to the state, any burden of the state higher than 30% is at odds with your growth and welfare goals. So we have a quantitative lift in my view that ought to be imported into codes of this kind. And the second element is a qualitative element I believe that there needs to be much more scrutiny around the quality of any public expenditure to see that it truly is dedicated to the achievement of first, public goods, truly public goods and; secondly, to the social safety net. All is else is beyond the jurisdiction of the state.

**FC:** You have touched on the next question. The New Zealand Business Roundtable has recommended a combination of tax and spending limits like the legislation in Colorado. What is your view of explicit spending limits? Say, holding government to a set percentage of the economy?

**RR:** I am a fan of that. I say 30%, personally I choose 25%, but it is in that territory. The problem with the Colorado "Taxpayer Bill of Rights" is that it only limits. It does nothing about the quality of the disclosure, about the frequency of the disclosure, the credibility of the numbers. It simply limits, at the margin, growth to growth and population. If your starting point is a bad one, and public spending is 40% then it is useless just confining them to discipline around the fringes. You have got to go to the core of the problem which is why this quantitative and qualitative issue is very important.

**FC:** Manitoba's public sector is the largest in Western Canada as a percent of the economy – is there not a risk of freezing that load on to the economy with such legislation. Would it be wise to phase it in after a period of public sector "right sizing"?

**RR:** I think it is important to address the fundamental role of the state, the interventions that it makes quite properly and those they should not make because they have perverse outcomes. Only when you have basically got a much better match between the core role of the state and

the claim on public resources should you then put lids on further encroachment.

**FC:** You find it amazing that the Manitoba government supplies services through state-owned Crown Corporations, particularly auto insurance and electricity. Why did New Zealand shed its state-owned enterprises? Can you give us the short case for private market provision of goods?

**RR:** The short case is that every nation, if it is serious about its welfare, has to use all of its resources efficiently so if the state business, notwithstanding that it might be quite “profitable”, is squandering resources because prices are not reflecting the scarce allocation of resources, then you are going to under-perform. You are compromising the best use of your resources. So, the case for the private management of these assets is first of all you get contestable markets, that is the best guarantee to the consumer of quality goods and services, a high level of service and very efficient low level prices generally. The private sector has to make the market every day in terms of the cost of its capital, it has to compete for that capital so it knows what things cost. It must price appropriately so you don’t have hidden transfers and hidden subsidies or cross-subsidies. New Zealand is not a saint in this regard, we do have an accident compensation regime, which the party of which I was a minister, made contestable. The new social-democrat coalition government undid that reform. Only 30% of our electricity generation has been privatized so it is no surprise that we have had a crisis in energy because the state enterprises do not respond to market signals.

**FC:** What would you do with the auto insurance monopoly?

**RR:** All monopolies are destructive of consumer and public interest whether they are public or private. What you have to do is have rules that guarantee contestability so, even if you wanted to continue to keep a regime of no-fault insurance you would have to open up the insurance supply to the contestable provision.

**FC:** Would you sell it?

**RR:** I personally would, but if you don’t want to take that step then you still have a public policy regime that says no-fault and no suing. I mean that even within that public policy framework you ought to have contestable suppliers and the moment you make state enterprise face competition it is likely to wilt in the face of that competition.

**FC:** What about the electricity monopoly?

**RR:** There ought to be no monopoly. First of all, in my view, you ought to split generation from transmission and distribution and you ought to have a contestable market at the generation end and a contestable market at the distribution end. I think there was an issue about club ownership of transmission but again that doesn’t have to be in the state hands, you could have a private club if you like that both generators and distributors belong to. But I think as a consumer you ought to be able buy from who supplies you with the most cost efficient service.

**FC:** In both cases, the argument for government ownership is that we get cheaper services. Your comment?

**RR:** No you don’t because the crown corporation does not properly price the supply of its services so it doesn’t have to compete in the financial markets for the cost of its capital. It doesn’t set prices to reflect the genuine cost of production, and it is inefficient and causes all sorts of distortions when you under price a resource. You get huge distortions that are as compromising for your economy as predatory pricing,

**FC:** Do New Zealand public services include GST, taxes and cost of capital in their pricing? There are many here who believe that these costs can be avoided through government ownership, is this a fallacy?

**RR:** Yes, they do. It is a fallacy, because capital is capital whether the Crown owns it or whether the private sector owns it and, unless you have a proper rate of return on your capital, you are squandering resources and capital is scarce – it has to be allocated and the rate of return is a way of insuring that you ration capital to the best uses. If the Crown excuses itself from a capital charge then effectively you are biasing the market in favour of the Crown at the expense of the taxpayer and, ultimately, at the expense of the consumer. You are short-changing yourself.

**FC:** New Zealand measures its services in terms of outputs or final units of service instead of inputs which are the items expended to produce services Why is this good policy?

**RR:** Because funding an input is no guarantee you will get the output you want. You might fund a lot of policemen but you might get lousy policing services. That’s not why you fund the police and the policing services you buy may not be of the quality that insure the outcome that you want which is, I feel, security and safety when I come to Winnipeg. So, you have to be able to move from recording inputs which is obviously no guarantee of the quality of goods and services produced. You have to make the further measurement which is, does the output I choose to purchase actually advance the outcome and the result.

**FC:** The next global wave of public service reform will target the heartland of healthcare and education. First, what would you do for education?

**RR:** Well, just in that sequence because I agree with it. I mean we did the easy things first which were the businesses, then we did the next easy things which were the hard infrastructure, like roads, water, electricity – I’m talking globally. It is the soft infrastructure that is now the target, health, education, pension, social services. Education was your first area – very clearly there are three elements. First, it is about contestability or competition in the supply of services. Two, on the demand side it is about funding choice, in other words allowing consumer to exercise choice and the third element is prices. Because all resources are scarce, consumers have to be able to trade-off price and quality and so prices must be a feature of the choice consumers make.

Quite a separate decision is, to what extent the state should be a player. I think the state should be a player in

education to the extent of its regulatory environment. I think there ought to be a high degree of disclosure required of education providers. So, that like a rating agency you know what you are buying and the credentials that are earned. There may be a role for the state in some core curriculum and there may be a role for the state in funding and maybe you fund universally or you fund on a means basis. A lot of middleclass welfare that is middleclass people - rob peter to pay peter - - but as you pass go you lose 50% because of the inefficiency of the state delivery and state bureaucracy. So, even if you do decide that there is a role of the state to fund, then you should fund demand, not supply. Those are the three elements.

**FC: What about vouchers?**

**RR:** There are two ways to do that, one is to give a tax credit or give a voucher. And, personally, there is no distinction -- the fiscal impact is the same.

**FC: There would be no difference then between the public and private sector?**

**RR:** No, because consumers can then make choices and it's not the ownership that matters, it is quality of the education they provide.

**FC: What about the cream-skimming argument where good schools unfairly attract the best students?**

**RR:** There is no cream-skimming argument, there is cream-skimming now in terms of zoning and New Zealand has had a system where if you live on the wrong side of the tracks, tough -- you are condemned to lousy schools. If you look at schools now you have two-tier schools. There is no way you could say the same of schools as you can of McDonald's. If I go to the poorest part of Winnipeg or the richest part of Winnipeg and go to McDonald's I get the same quality of hamburger but I am sure if I go to the poor part of Winnipeg and the better part of Winnipeg, I won't get the same quality of public school. You have got two-tier now, I mean, get real. The voucher is about genuine equity, it is about giving choice to people who don't have the purchasing power now. Just because you are poor doesn't mean to say that you can't make good choices for your kids schooling.

**FC: How about healthcare?**

**RR:** Healthcare is more difficult but I think it is the same approach. Three things you want are contestability, competition and supply, choice and demand and prices. And, the way to do that may be a patient passport. In other words you take the state funding that otherwise you would spend per capita for each man, woman and child, and you risk rate it and you give it to the individuals and say, now you choose. Now Roger Douglas would go further and mandate the requirement to take social health insurance which in my view is tax just by another name, it suffers from the same defect. So, he and I part company on that issue.

**FC: O.K., so let's say I had a passport for my family that was worth say \$10,000 and I didn't use it all. What would happen to the money?**

**RR:** Well, you couldn't use it at McDonald's so it would only be available for health expenditure but you may decide as a family that you are just going to have catastrophic insurance

and you are going to self-insure for the little stuff. So, you could spend all of that on catastrophic insurance or you could put in that insurance bank and, like Singapore, if you didn't use it, it is an asset that your kids can inherit so there is an incentive not to draw it down for trivial things. It is an incentive to exercise every day and an incentive to look after yourself because it is like a health bank and you are able to draw it down when you really need it.

**FC: You are really talking Medical Savings Accounts?**

**RR:** Yes, like in my view you should have voluntary savings accounts for pensions.

**FC: Describe the labour market changes your government introduced in the early 90's**

**RR:** They were pretty straight forward. We had the equivalent of a Polish shipyard -- it was highly unionized and was great for the insiders, it was a racket for the insiders and tough for the outsiders who were the unemployed. We dismantled all of that in one stroke -- we made a basic proposition which is, you are free to work. The bargain for labour is only between two people, that is the person supplying the labour and the person buying the labour. The government had no business at the table in terms of mandating national agreements and the union had no business at the table in terms of mandating union standover tactics, rules of the road, etc. And that's your remarkably simple proposition that led to the greatest rate of job growth in the OECD for New Zealand.

**FC: Did it hurt or help the workers?**

**RR:** It clearly helped because you get full employment -- I mean everybody gets to join the bus -- you don't have insiders and outsiders.

**FC: We have considerable controversy over a government policy that will require construction companies working on the \$700 million floodway expansion to become unionized. Your thoughts?**

**RR:** Well, it is a racket. It's insider trading -- if the Manitoba government was an SEC (Securities Exchange Company listed on the stock market) company they would be struck off and put in jail by Elliott Spitzer for insider trading. What they are effectively doing is the government is mandating its mates to get the job. That is no way to conduct public policy or use public finance -- you must have contestable regimes -- there is only one decision a politician can make and that is what is the value for money and is it an important public work. I mean, I agree that a public floodway is a genuine public good but just because it is a public good is no reason to engage in a union racket.

**FC: You mentioned that the G7 countries will likely be run over by emerging nations like China, India, Brazil and Russia. Are you saying that we leave public services like healthcare and education unreformed at our peril?**

**RR:** Yes, you leave the government sector unreformed at your peril because you have got a huge bureaucratic break. Governments -- their interventions, their projects, their schemes don't create jobs. Individuals and firms create jobs, entrepreneurs create jobs and I have a saying that says "if you are rich you can be stupid for longer than if you

are poor". So if Brazil, Russia, India and China are going forward, they are not perfect but they are reforming fast, growing fast, learning fast and I am saying that for the developed world, particularly the G7, you sit on your hands at your peril. I mean you are going to get run over in the rush.

**FC: The case for the flat tax is?**

**RR:** The case for the flat tax is an equity issue and an enterprise issue. The equity issue is the flat tax is not regressive, in other words, if you earn more you pay more under a flat tax, although it is paid on effort, it doesn't penalize hard work, risk and enterprise. You know that if you further yourself, put in extra hours, take the extra risk, you are not going to get clobbered by the government. The government is a free rider and not only free riders – I mean they stop the game, and that is very counterproductive.

**FC: What countries have a flat tax?**

**RR:** Yes, Russia's flat tax has come out of the ranks of President Putin. I mean he was the heart of the KGB and they have a flat tax. All around the former Soviet republics – Estonia, Latvia, Lithuania -- have all got flat taxes. They are leading the way in terms of tax competition. What's really great is that I think there are internal and external forces for good. I am very optimistic.

The internal forces for good are fiscal constitutions, regulatory constitutions, monetary constitutions that constrain the government so that your institutional and policy approach dictates the politics. Most politicians are followers, not leaders. They talk about maintaining public confidence rather than creating an agenda and constitutional constraints and institutional constraints help frame that debate and change the nature of the debate.

That is the good news internally so the growth of fiscal rules is very pleasing. It is not a left and right issue this is a modern government issue.

The external forces are equally compelling. The external forces are two. One is that there is now a good deal of sovereign competition and you ought to have provincial competition here. I mean, just because British Columbia might have a lousy regime, doesn't mean to say Manitoba has to have a lousy regime. I want to see "muscular" Manitoba not this nonsense of "have not" province. I mean, just strike those words from the record – it is just outrageous that you should, even with a straight face, describe yourselves as "have not". Come on, you're beggars on the street, get real guys! So, Manitoba could be muscular, but the external forces of tax competition, globalization, you know competition from countries like Brazil, Russia, India and China, are going to force countries to put their own houses in order.

**FC: There is a well-orchestrated push for changing Canada's electoral system towards the proportional representation system you have in New Zealand. Is PR a good thing?**

**RR:** Don't do that – don't touch it – it is a poison pill. It is utterly destructive of the ability to develop, frame and enact high quality public policy. Proportional representation effectively swings the balance in favour, if you think of representative government, away from good government towards so-called high quality representation but utterly destructive of good government. You get a big democratic deficit because the tail wags the dog. The little guy with one vote can dictate what lives and what dies. So you get the tyranny of the minority with the PR. Don't touch it!