

# Innovative, adaptive and entrenched, but not widely replicated

The New Zealand Public Finance Act @ age 30

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# An inside-outsider view

1. An example of problem driven iterative adaptation, but with normative attributes
2. Positively entrenched
3. Reluctant replication in other countries
  - Notwithstanding observable international interest and intrinsic intellectual appeal

# Big bang or innovative and adaptive

- The PFA is a law of 88 sections, and seven schedules; latest reprint is 151 pages long
  - Amended 58 times in 30 years
- **Ready, fire, aim**
  - Appropriation types
  - Fiscal responsibility
  - Crown entities
- **Problem Driven Iterative Adaptation (PDIA)**
  - away from pre-determined solutions; towards locally prioritized problem solving; away from an over-reliance on (and the resource absorption of) advance planning; towards learning and adapting positive deviance
  - away from formal big ‘M’ and big ‘E’ monitoring and evaluation; towards adoption of integrated feedback loops
  - rather than being a top-down exercise where the head learns and implementation is just muscle; a move to diffusing practice based on what works at the level of the implementers
  - ...but PDIA tends to be norm free; so is this PDIA-NA (i.e. with normative attributes)

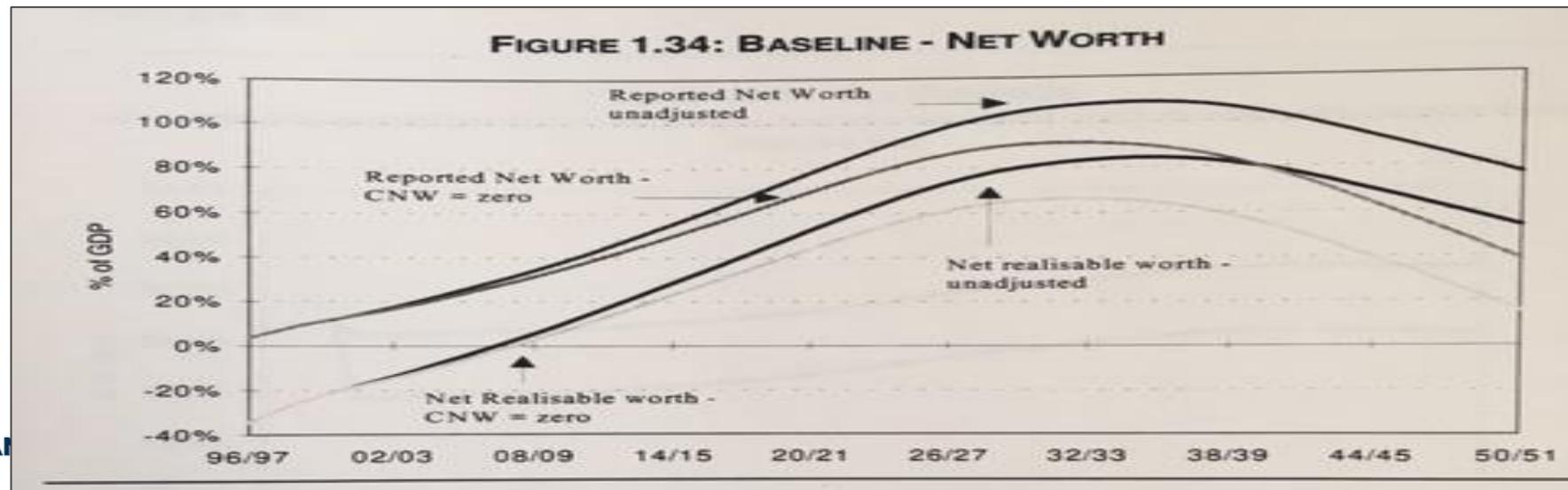
# Innovation and adaptation have led to a different place

- **Conceptual model**

- PEBs & the comparative institutional approach – the visible hand of Coase and Williamson
- Management accounting and control and financial reporting are not just about accounting
  - Rebalancing trade-offs

- **Result**

- The story of sovereign net worth
  - 1996: 3.6% GDP; Now: 43% GDP (May 2019), and within the Bagrie range
  - Australia: negative 13.5 % GDP to negative 23% over same period despite expansion
- Living standards, Wellbeing, and maybe even the Tiaki promise to care for New Zealand



# Iteration with positive entrenchment

- **Commitment**

Not all commitment problems are solvable, but when reforms stands test of time then entrenched

- **Entrenchment (from Paul Starr)**

A constraint on *reversibility*; and a constraint on *further change*

Requires active *reinforcement, renewal, and resilience*: compare PFA with Gramm, Rudman, Hollings

- **Test of time**

Withstood 11 elections

Four changes of government in the intervening 30 years

Foundations not *reversed*, notwithstanding 58 amendments

Adaptation, *reinforcement, renewal*

# PFA supported by strategy, culture and lock-in

Lens of Starr; strategic entrenchment (SE); lock-in(LI); cultural entrenchment (CE); degree to which they rely on claims for legitimacy (CL) or institutionalized systems of authority (SA).

Box	Commentary
A (SE;CL)	Early record of consolidation of the budget, in contrast to previous years, reinforced direction of travel.
B (SE;SA)	Treasury analytical dominance of NZ bureaucracy; professional buy-in to an accounting model. Bipartisan support to major aspects of PFA.
C (LI;CL)	Early gains were consolidated; costs of undoing change appeared higher. Creation of a 'new normal'.
D (LI;SA)	MMP meant that large scale reforms, such as undoing major legislation, had become harder. No more Muldoon-style majorities; a shift from fastest law-making in the west
E (CE;CL)	Global recognition; movement from accounting profession into IPSAS reaffirming NZ action.
F (CE;SA)	Innovative operationalization in policy of PFA main dichotomies. Treasury support with 'Vote Analysis' training.

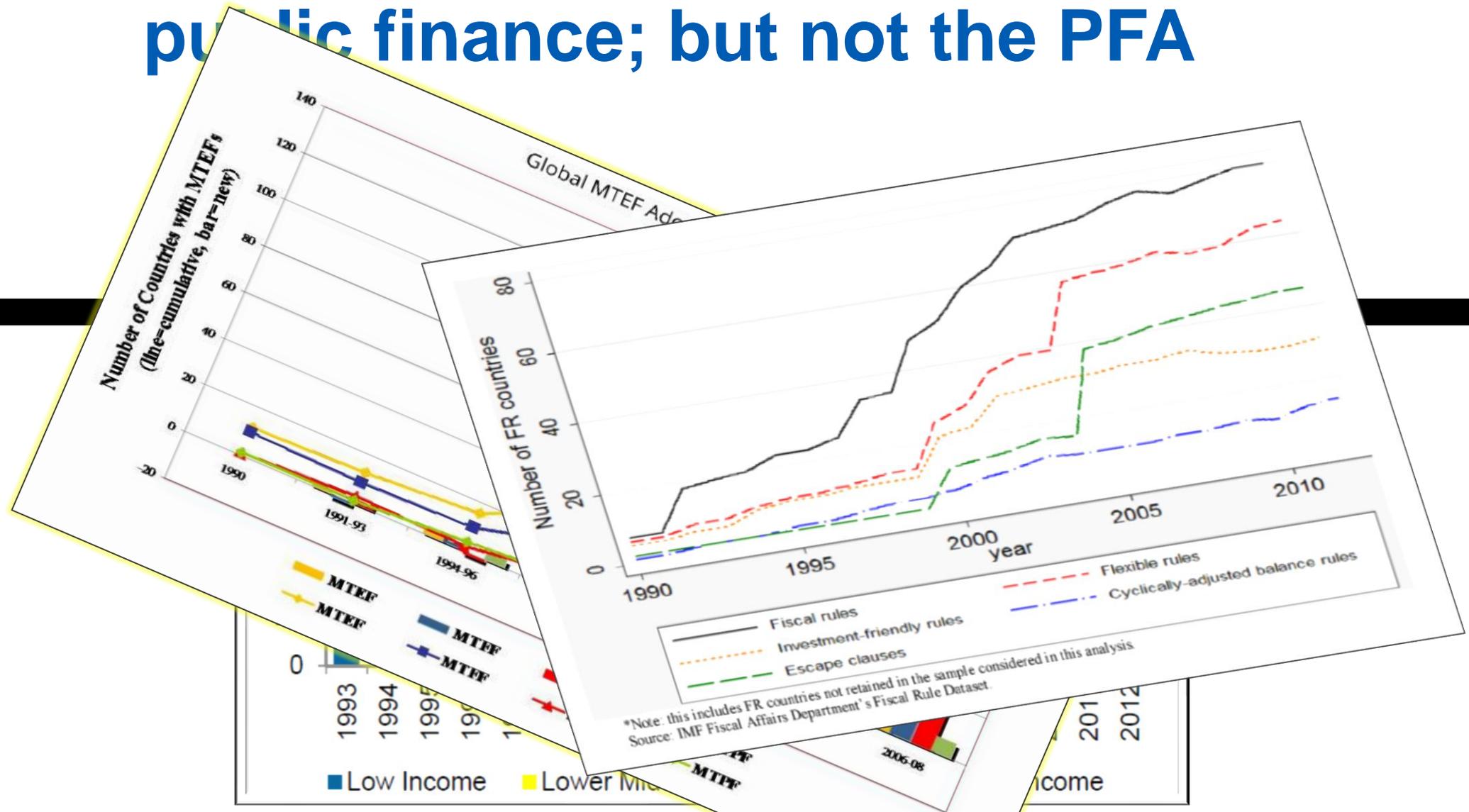
# MMP lock-in foreshadowed; assisted positive entrenchment

WDR 2017; Commitment; coordination and cooperation  
similar to positive entrenchment model

	Reform	Not reform
Reform	Cell A; Positive Entrenchment 2, 2 (R, R)	Cell B 0, x (R, NR)
Not reform	Cell C x, 0 (NR, R)	Cell D; Negative Entrenchment 1, 1 (R, R)

(Source; World Bank, 2017)

# Replication is common and fast in public finance; but not the PFA



# Replication scorecard shows reluctance (6 red; 3 amber; 1 green)

- 1.The separation between input and output..
- 2.The nature of the business of a department versus that of the Crown.
- 3.The distinction between cash and accruals..
- 4.The differentiation between the ownership interest (with such items as a capital charge) and the purchase interest (output contracting).
- 5.Clear distinction of the economic purpose of appropriations per section 7A, necessary to reflect 1-4 above.
- 6.The dissolution of the Consolidated Fund.
- 7.Extensive use of transparency and accountability.
- 8.Definition of full public sector entity for fiscal management purposes, with use of adjusted operating balance.
- 9.Use of independent accounting frameworks to determine appropriate fiscal and financial treatment.
- 10.Integrated with other key legislation to create reinforcing performance management.

1. Few have adopted output classes
2. Not in any obvious way, although entity-based reporting to complement comprehensive reporting is consistent with this
3. Progress with two-thirds of all countries expected to have accruals over next few years. Accrual budgeting has had extremely limited rollout, with some failures.
4. Not been commonly adopted in language or in design of public financial management for the general government sector
5. Not adopted significantly
6. Not adopted significantly if at all
7. Transparency now a central part of the international fiscal vocabulary. But hard fiscal rules tend to dominate.
8. Not adopted significantly
9. Limited adoption
10. Unusual to have such clear legislation about accountability

# Reluctance to replicate #1

	Key PFA feature	Universalist concern	Instrumentalist fit	Role of international support
1	Inputs, outputs and outcomes	No obvious concern	Can't control to outputs if no control to inputs; basics first. Insufficient attention to outcomes in NZ.	Basics first, but generally supportive in form of program budgets; OECD investigated output types.
2	Crown and department	Distinction not meaningful	Separate entity management second order issue to financial control	Generally supportive in entity reporting, but not interested in devolved bank account management, as may compromise central financial control.
3	Cash and accruals	Valuation issues are insurmountable and do not recognize the enduring nature of state	Lack of capacity; idiosyncratic public financial rules mean GAAP not easily applicable	Supportive, but not aggressive. Under pressure from Australia and NZ, GFS2001 adopted accruals. Some 15 years later the Fund stress test used balance sheet. Limited rollout in Fund programs. IMF launched balance sheet data for 38 countries in 2019.
4	Owners and purchase	Citizens have claims; state needs to address universally. Not useful distinction	Pricing to reflect return on capital not relevant in general government sector; only exist to deliver services	Not generally supported; no operationalization of capital charging.
5	Appropriation structure	Economic substance in appropriation not necessary as key issue is to provide legal right to disburse	Constitutional or organic law restrictions	Not generally supported.



# Reluctance to replicate #2

6	No consolidated fund	Central to the concept of the state as envisaged in constitution	All funds flow into CF, and appropriations are required to move funds out	No general support for moving away from CF, as seen as core to financial control and the control of cash
7	Aggregate fiscal intentions by transparency and principles only	Need to constrain the state	Hard rules will constrain behavior; transparency will not	Support shown; IMF Fiscal Transparency Code explicitly incorporates either rules or non-binding targets in principle 2.3.1. Same for PEFA 15.2. However, demonstrated bias operationally for hard rules and fiscal councils. Focus on 'escape clauses'.
8	Fiscal entity; fiscal targets	Budget supported sector or general government should be separate	Appropriations reflect CF	Strongly supportive of general government reporting separate from wider public sector
9	Independent accounting rules setting	Public sector accounting is substantively different from private sector accounting	History of endogenous rule setting; usually resting with MOF	IOs split on GFS and IPSASB. See 8. Above.
10	Integrated with other organic laws	Hard-edged contracting not good fit for concept of caring state.	One reform is tough; three reforms is tougher	Agreed in principle, but non-joined-up effort at IOs in effect meant unlikely (i.e. tax advice from tax folks; PFM advice from PFM folks; civil; service advice from GOV folks; GFS advice from Stats folks)

# Some tentative thoughts on future direction

## Learn from failures

- Appropriations should be sharp **NOT** loose in their accountability
- Recall the history of program budgeting and Musgravian public finance

## Good objective of more joined-up government

- Government is not the solution
- Is appropriation the right tool?

*Focus on the problem to solve, and try to apply the right tool to achieve that solution*

# Happy 30th: Let's celebrate achievements

## *It has done the basic hard stuff of public finance*

- Withstanding two major public finance shocks - the global financial crisis and the Canterbury earthquake. Balance sheet absorbed the shocks, minimized welfare losses, and then rebuilt, as intended
- Avoiding procyclical fiscal policies; an important test for managing public finance, demonstrating the importance of flexibility rather than hard fiscal rules

## *But so much more*

- Encouraging innovation in thinking about the state and the estate, and the intertemporal nature of the social contract to the level of the individual

# Annex: Credible commitment entrenched

	<b>Strategic entrenchment</b>	<b>Lock-in</b>	<b>Cultural entrenchment</b>
<b>Force/material advantage/pressure (claims for legitimacy)</b>	A. Create facts on the ground; faits accomplis	C. High costs of change from increasing returns; cumulative advantage	E. High threshold of adoption for new beliefs and identities from embedded social ties
<b>Institutionalized system of legitimate authority</b>	B. Exigent rules of change; deliberately institutionalized supporting interests	D. Political lock-in; high emergent costs of change from choices at critical junctures	F. High threshold of adoption for new beliefs and identities from institutionalized deepening

(Source: Paul Starr, *Entrenchment*, 2019)