Reinvention and Retrenchment: Lessons from the Application of the New Zealand Model to Alberta, Canada

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Abstract

Is New Zealand a model for "reinventing" government and cutting spending? The government of Alberta, Canada, consciously replicated significant elements of the New Zealand model to attain fiscal balance and public sector reorganization, including the core element of restructuring institutions to change individual behavior. Despite broad similarities in policy content and outcome, differences in the specific content of policy and the politics of policy implementation led to differences in the sustainability of reform and the location of budget cuts. Alberta's Progressive Conservative party emphasized expenditure cuts where both the New Zealand Labour and National parties emphasized government reorganization and the introduction of market mechanisms. Contrasting these efforts to balance budgets and reinvent government suggests that there is considerable variation in the "model," and that left governments in general are probably more likely to pursue and succeed at the reinvention of government, while stinting fiscal balance. Right governments, on the other hand, are more likely to achieve short-run fiscal balance at the expense of successful reinvention. In turn this suggests that while the partisan orientation of the reforming party matters, neither has an ideal policy mix for long-term fiscal stability. Alternation of governments may provide the best policy mix.

And let me speak candidly to those who have their eyes on the [budget] surplus. Forget it. The only time we will make decisions about spending money is right now—at the beginning of the year when the budget is set. At the end of the year, when we know the size of the surplus, there is no choice. No one can choose to spend the surplus—it must go to pay down Alberta's debt. That's the law in Alberta. (Jim Dinning, Provincial Treasurer, Budget Speech, February 22, 1996)

THE NEW ZEALAND MODEL: SO WHAT?

New Zealand arguably presents the extreme case of policy reform and public sector reorganization among the developed countries in terms of the extent

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and speed of policy and institutional changes [Kelsey, 1996; Schwartz, 1994b]. As such, the New Zealand model has practical relevance for other societies for two reasons. First, it provides a rhetorical model suggesting that policy reform can be done and showing how in broad outlines it can be achieved politically. Second, it provides specific content for policy reform aimed at government reinvention and fiscal retrenchment.

The influence of the New Zealand model can be clearly seen over the past four years in Alberta, Canada's fiscal retrenchment and public sector reorganization. Alberta is an interesting extension of the New Zealand model for three reasons. First, the *absolute* level of public expenditure has been cut in *real* per capita terms by about 27 percent over four years. In contrast, in most other societies, "cutting" usually means cutting the rate of growth. Even in New Zealand the absolute level of public spending in real terms grew 6.6 percent under Labour's six-year tenure, while falling roughly 5 percent under National's first four years, to end up in roughly the same place [Organization for Economic Cooperation and Development (OECD), pp. 141, 143; New Zealand Treasury, 1995].

Second, demographically, economically, and electorally, Alberta is quite similar to New Zealand. Because Albertan policymakers drew consciously on the New Zealand model, the Albertan experience casts light on our understanding of New Zealand's reform (and policy reform in general) by showing what is and is not idiosyncratic to New Zealand's reform process. What Alberta's "change team" could not transfer is probably untransferable; what they chose not to transfer tells us how politics shapes policy reform.

Finally and practically, Alberta has become the implicit model for policy reform at the provincial level in Ontario and lately, it seems, also in Quebec and British Columbia. Together these four provinces constitute 86 percent of Canadian GDP, so to the extent that Alberta's reform was modeled on New Zealand's, so, too, for the most part is Canada's [Office of the Auditor General, 1995; Commission on Taxation, 1996].

Put simply, this article asks (a) were the causes of policy reform in Alberta objectively or subjectively similar to those in New Zealand?; (b) was the content of policy reform the same?; (c) were the means to that end similar?; and (d) what explains the similarities and differences? The conclusion develops the larger political and policy implications of those differences, asking what these similarities and differences tell us about public sector reorganization.

To telegraph the conclusions, in both cases Treasury bureaucrats and politicians sought to reinvent government—to institutionalize new incentive structures for politicians, public servants, and citizens—as an essential prerequisite to long-term fiscal stability. But differences in the social base of the party starting policy reform in part led to differences in the specific weight given to austerity as opposed to reinvention in this process. The New Zealand Labour Party's greater dependence on support from public sector workers, their unions, and state dependents forced it to pursue public sector reorganization more aggressively, because it could not simply and easily cut spending. In contrast, the relatively similar social base of the New Zealand National (i.e., conservative) Party meant that its policy more closely resembles that of Alberta's Progressive Conservative Party (PCP), which has secured short-run fiscal balance, but has been relatively less successful in its pursuit of public sector reorganization.

That partisan considerations intrude into policymaking is not shocking. But the comparison here shows that even within what is essentially the same model for reform, variation has significant consequences. Left governments are more likely to emphasize and perhaps succeed at reinventing government in order to institutionalize long-run fiscal stability, while deferring expenditure cuts. Right governments are more likely to emphasize and achieve short-run fiscal balance while putting off reinvention. Unhappily this suggests that neither the Left nor the Right has an ideal policy mix for attaining fiscal stability. Partisan alternation may be necessary for long-run stability, in which ideally a left government institutionalizes a new, market-driven public sector, and then a right government institutionalizes fiscal stringency. However, paradoxically, the extreme degree of retrenchment achieved in both New Zealand and Alberta occurred because these new institutions were designed as much to constrain *politicians* as to constrain the public.

UNDERLYING AND PROXIMATE CAUSES FOR PUBLIC SECTOR REORGANIZATION

The objective and subjective sources for policy reform were fairly similar in New Zealand and Alberta. In both New Zealand and Alberta policy and public sector reform occurred after conservative governments' efforts to diversify the economy through public or publicly sponsored investment failed. These failures seriously undermined the legitimacy of state economic intervention, the stability of the fisc, and politicians' standing. Both economies historically relied on external financing of infrastructure for their resource-based economies, and both suffered severe contractions when export prices fell and creditors choked off new loans. Both governments had their debt downgraded by international rating agencies before the reform process started. So, in both, politicians sought retrenchment and public sector reorganization to reassure both local voters and external creditors. Policy reform in the 1980s and 1990s thus represented a major reversal of prior policy in which the state tried to diversify the economy with targeted investments. But because import substitution industrialization in New Zealand in the 1930s and 1950s created both stronger unions and a viable Labour party, New Zealand and Alberta chose different items from the typical policy reform menu.

New Zealand

State economic intervention in New Zealand deepened in the 1970s. After 1975, Robert Muldoon's National government borrowed overseas to diversify the economy by subsidizing new manufacturing industry and additional agricultural exports. National hoped to offset declining terms of trade and European Community quotas on food imports by increasing export capacity.

Subsidies amounting to about NZ$650 million (US$565 million) annually by 1982 drastically lowered the cost of capital for agriculture [Economic Monitoring Group, 1984, p. 5]. National's subsidies increased dairy export values by 45 percent between 1973 and 1982, increased the number of sheep from 55 million to over 70 million between 1975 and 1982, and increased the number of farmers by 16 percent between 1975 and 1984 [Evans, 1987, pp. 112–113]. Subsidies amounting to over 18 percent of the value of manufactured exports (including processed foods) boosted their share of total exports from 6 percent in 1975 to 22 percent in 1985 [Wooding, 1987, pp. 89–97]. Finally, in the so-called Think Big program (1982–1984), National invested nearly NZ$5 billion in heavy industry and the energy sector without generating investment returns sufficient to cover debt service costs. By fiscal year 1983–1984 subsidies and bad investments drove the fiscal deficit to 18 percent of government spending and 9.1 percent of GDP [Economic Monitoring Group, 1984, pp. 7–8].

Muldoon bridged the fiscal gap by borrowing abroad. Total official debt grew from 10.7 percent of GDP in 1975 to 27.6 percent in 1984, and total debt service swelled from 8.1 percent of tax revenue to 19.0 percent [Economic Monitoring Group, 1987, pp. 86–89]. Throughout this period the Treasury and Reserve (i.e., central) Bank consistently and futilely argued for more market rational policy. By the early 1980s, it was clear that policy would have to change, and indeed National made hesitant steps toward liberalization.

The proximate causes for the policy shift came in early 1984. Faced with defections inside National (partly over state economic intervention) and a downgrading of New Zealand's credit rating, Muldoon called and lost a snap election to Labour. Local and foreign investors, correctly fearing that Labour would devalue the overvalued New Zealand dollar, fled into other currencies. When the Reserve Bank looked abroad for bridging loans to sustain its foreign currency reserves, international banks flatly refused, shocking both the Reserve Bank and Treasury, and giving the incoming Labour party an excuse to undertake large-scale reform. Subjectively, New Zealand had "hit the [foreign exchange] wall," an aphorism Canadians later picked up.

Alberta

The Albertan government's economic intervention was more circumspect than New Zealand's until the 1970s, which explains its relatively smaller industrial base. Growth after World War II was almost wholly resource driven, albeit shifting from agriculture to oil and natural gas. Social Credit governments from 1935 to 1971 socialized risk for farmers, provided infrastructure for American multinational oil firms, and asserted state control over gas transmission but otherwise kept their hands off the economy. But the Progressive Conservative Party government elected under Peter Lougheed in 1971 tried to capture oil-shock swollen rents from oil and gas extraction to expand local business and diversify the economy [Mansell, 1997; Richards and Pratt, 1979].

Petroleum royalties soared from C$260 million in 1972 to peak at C$1.4 billion in 1974. Oil and its ancillary industries grew so fast that total provincial revenues roughly doubled during the 1970s even after a 28 percent cut in income taxes in 1975. The government was able to sequester about C$8 billion—roughly 30 percent of oil rents—into the Alberta Heritage Savings Trust Fund (AHSTF) [Mansell, 1997; Smith, 1991]. Despite this, spending also rose, increasing roughly 60 percent per capita between 1979 and 1982. By 1980 oil and gas directly generated 25 percent of gross provincial product (GPP) and 55 percent of state revenues after diversions into the AHSTF.

Like Muldoon, Lougheed recognized the dangers in relying so heavily on one commodity, and like Muldoon he preached conservative economics while expanding state spending, the social safety net, and state guaranteed investment in a desperate search for growth. The Lougheed government built hospitals and other public facilities freely. It also committed roughly C$7 billion of loans, loan guarantees, and direct investment to local industry by 1981.

The introduction of the federal National Energy Policy (NEP) created a local recession by shifting about C$1 billion in rents out of Alberta toward the center annually. Like Muldoon in response to the 1979–1982 recession, Lougheed opted to ride out the NEP with a Keynesian bridging policy, the "Alberta

Economic Resurgence Plan." One side of the bridge rested on the prosperity created by the Iranian oil shock, and Lougheed hoped to set the other on a more diversified economy. However, when oil prices fell 50 percent after 1986, the bridge suddenly had no pier in the future. After a brief effort at fiscal restraint, Lougheed's successor, Getty, committed even more public money to private projects in an effort to secure continued growth. Loans and investments grew to C$12.2 billion by 1992 [Alberta Financial Review Commission, 1993, p. 30]. Most of this investment failed, and by 1994 the 10 largest write-offs amounted to over C$2.2 billion [Lisac, 1995, pp. 1–3; Mansell, 1997].

By indirectly committing the rents accrued in the AHSTF to these disastrous investments, the Lougheed–Getty governments delegitimized state economic intervention just as Think Big in New Zealand did. Concurrently, the public perception of corruption surrounding these investments and of political indifference towad their failure created a mood in which radical change was more acceptable [Lisac, 1995, pp. 15–25]. Financial markets also took a dim view of these investments, downgrading Alberta's debt immediately after the 1986 oil shock, and again after the largest write-offs in May 1992 [Kneebone, 1994, p. 159].

Still, unlike New Zealand, Alberta remained a net creditor through the 1980s, and the shift to a net debtor status occurred only in fiscal year 1991–1992. Interviews suggest that what troubled fiscal bureaucrats most was not the absolute level of debt but the trend, as net debt roughly doubled every year for several years. Faced with a rising tide of red ink on the budget, and red faces over his fellow politicians' apparently inexhaustible appetite for publicly funded perks, Getty stepped aside in late 1992. It remained for his successor, Ralph Klein, to turn public anger into the sense of crisis that would permit significant changes, and not insignificantly permit the PCP to win yet another election.

WHAT POLICY REFORM SOUGHT

Policy reform in New Zealand and Alberta has remarkable similarities, particularly in terms of the central aspect of the New Zealand model: the reengineering of institutions and thus individual behavior. Reformers in both New Zealand and Alberta sought to change the incentives governing people's behavior in order to attain budget balance within four years, and to promote efficiency and responsiveness in the public sector. Both sought to lock in reform through tax and expenditure legislation. And both had to first control politicians' behavior in order to get their broader goals. However, the relative weight given to fiscal balance as opposed to public sector reorganization did differ between the two. This section first details the fiscal consequences of policy reform, then focuses on the intellectual origins of the new policies, and finally shows the relationship between these ideas and new ways of channeling the behavior of politicians and individuals.

Fiscal Consequences of Reform

On a consolidated basis the New Zealand Labour party brought the budget into nominal balance from 1984 to 1990, by raising taxes and selling assets. As noted earlier, under Labour expenditure rose absolutely in real terms by about 6.6 percent, while falling from 38.7 percent of GDP to 35.6 percent. But revenues rose even faster, increasing by over 40 percent absolutely in real terms, and from 31.7 percent of GDP in fiscal year 1984–1985 to 39.6 percent in fiscal year 1989–1990. Introduction of a Goods and Services Tax (i.e., VAT) that eventually reached 12.5 percent accounted for much of this gain [OECD, 1989, p. 18; OECD, 1991, p. 39].

National turned this rough fiscal balance into absolute surpluses despite a recession-induced instability in revenues and expanded demand for services in its first term and growth in its second. Expenditure fell slightly in absolute terms, and thus fell relatively to 34.7 percent of GDP by fiscal year 1994–1995. Revenues also stayed fairly constant absolutely while falling to about 36 percent of GDP. The government predicted a surplus of 3 percent of GDP for 1996–1997, and was predicting a surplus of 7.7 percent of GDP for 1997–1998 until the election of October 1996 led to slightly expanded spending for health, education, and welfare. Despite National's extensive cuts—relative to Labour—in real terms the absolute level of government spending is still fairly close to what it was when Labour left office. Although government spending has fallen in proportion to GDP, this reflects rising GDP, not falling spending.

In contrast, the most striking feature of Klein's administration has been a 20 percent absolute nominal reduction in spending in order to attain a balanced budget by fiscal year 1996–1997. *Front loaded* cuts were designed to reduce a C$3.415 billion deficit in fiscal year 1992–1993, to C$2.5 billion in fiscal year 1993–1994, C$1.8 billion in fiscal year 1994–1995, and C$0.6 billion in fiscal year 1995–1996. Instead these budgets produced significant surpluses in fiscal year 1994–1995 (nearly C$1 billion) and fiscal year 1995–1996 (nearly C$400 million) because of unusually high resource revenues [Alberta Treasury, 1995a, p. 15; Alberta Treasure, 1996, p. 43]. These surpluses were not used to lessen the overall severity of the cuts, except for an easing of cuts to health care.

This recision of spending is all the more remarkable because it touched some of the most politically sensitive areas, like core health, education, and welfare activities. Over four years, Klein proposed cutting basic education by a nominal 5.6 percent, higher education by 15.3 percent, health by 17.7 percent, and generic welfare by 19.1 percent. Other departments took average *nominal* reductions of 27 percent. The most recent budget responded to public protests by slightly lessening the severity of cuts to health and kindergartens, but the bulk of the cuts have still taken place (see Tables 1 and 2).

Table 1. Revenues (C$million, current).

	1992–93	1993–94	1994–95	1995–96	1996–97[a]	1997–98[b]	1998–99[b]
Income and other taxes	5601	5592	6458	6565	6682	6860	7040
Resource revenue	2183	2817	3378	2643	2646	2813	2809
Federal transfers	2389	2021	1855	1714	1379	1166	1022
Alberta Heritage Savings Trust Fund and other	3299	3725	3393	3357	3452	3442	3460
Subtotal	13,472	14,515	15,084	14,276	14,167	14,281	14,331
Revenue cushion	NA	NA	NA	NA	(545)	(561)	537
Net Revenue	13,472	14,515	15,084	14,276	13,622	13,720	13,792

[a] Estimated outcomes.

[b] Target budget.

Table 2. Expenditures (C$million, current).

	1992–93	1993–94	1994–95	1995–96	1996–97[a]	1997–98[b]	1998–99[b]
Program spending	15,612	14,649	13,043	12,412	12,277	12,300	12,055
Health	4175	4039	3835	3668	3705	3900	3627
Social	1722	1598	1353	1368	1394	1352	1339
Primary education	2879	2971	2748	2797	2700	2755	2755
Tertiary education	1306	1288	1163	1090	1106	1106	1099
Debt service	1232	1460	1535	1492	1401	1332	1305
Total spending	16,844	16,109	14,578	13,904	13,678	13,632	13,360

Source: Alberta Treasury [1996].
[a] Estimated outcomes.
[b] Target budget.

The Intellectual Sources for Public Sector Reorganization

From the reformers' point of view, all this budget balancing would be pointless if the underlying behaviors producing deficits did not change. This is clear in the ideas that animate policy reform in both New Zealand and Alberta. In New Zealand the Treasury set the agenda for policy reform in a series of remarkable election briefing documents that viewed political and social behavior through the lens of the new economics of organization, particularly public choice and principal-agent theory [New Zealand Treasury, 1984, 1987; see also Boston, 1991; Oliver, 1989; Schwartz, 1994a]. Treasury sought to reduce the ability and desire of agency personnel, their clients, and politicians to engage in the rent-seeking behavior that public choice theory posits by changing institutional structures. Treasury wanted to use market pressures to force agencies to compete on cost and quality grounds, to give consumers an incentive to search out better or cheaper services, and to make it harder for politicians to hide the real tax cost of additional public services. Treasury also sought legislation to insulate the budget-making process and key economic institutions, like the Reserve Bank, from societal pressure, and to make policy processes more transparent [Kneebone, 1997].

Alberta Treasury did not produce any full-scale theoretical analysis of the public sector akin to the New Zealand Treasury's [1987] *Government Management*, drawing instead on a variety of sources to produce its *Better Way* documents [Government of Alberta, 1994, 1995]. Consequently, these are detailed action (i.e., business) plans, rather than the full-fledged world view found in the New Zealand Treasury's briefing papers. Nonetheless, the influence of New Zealand as well as other ideas are perceptible in the *Better Way* series [Author interviews with Alberta Treasury staff, 1996]. These ideas fall into three categories: "local" ideas; Canadian and U.S. ideas; and New Zealand ideas. Atlhough the influence of New Zealand ideas was diffuse and often indirect, their impact should not be dismissed given the wide currency they had achieved in the media. From 1984 to 1995, for example, the *Economist* magazine ran 33 articles or editorials on policy reform in New Zealand, and constantly invoked New Zealand when recommending policy reform elsewhere. Not surprisingly, Albertan Treasury officials were quite familiar with New Zealand's reforms.

Local Albertan bureaucrats and a few politicians familiar with trends current in the business world had the most immediate impact, simply shifting these ideas over to the public sector, just as in New Zealand and elsewhere. Elaine McCoy, an important link between bureaucrats, business, and politicians, is a salient example. Over 10 years in different ministries she introduced and refined the "business plan" idea described later. When Klein defeated her in the PCP's 1992 leadership contest, he appropriated her call for the extension of the business plan model to the entire government [Lisac, 1995, p. 68; McCoy, 1992]. McCoy's plan dovetailed with similar rationalization efforts then current in Alberta Treasury and the Department of Economic Development and Trade [Lisac, 1995, p. 48]. McCoy's old office, the Department of Labour, remains one of the most innovative and has gone the farthest in terms of delegating authority to the private sector [Ford, 1995; Bruce, 1997].

Contemporary experimentation by the Canadian federal government and by U.S. states, particularly as codified in David Osborne and Ted Gaebler's [1993] *Reinventing Government*, also influenced Alberta. Gaebler made repeated visits to Alberta in 1993, when business plans were being extended to the entire government [Lisac, 1995, p. 146]. At the same time, the Canadian federal government launched a number of initiatives that reduced the number of departments, froze hiring, cut spending, and gave managers more liberty with regard to employees. But it also reinforced grievance and dismissal protection for employees, made unionization easier, and did not systematically introduce markets. All these experiments, particularly Canadian federal efforts, drew on the New Zealand experience. For example, the federal Office of the Auditor General [1995] codified the New Zealand experience in *Toward Better Governance*, which relied heavily on New Zealand Treasury's understanding of the reforms.

New Zealand's experience and public choice theory influenced the content of Alberta's policy reform more directly two different ways. Bureaucrats had absorbed the largely public-choice-based New Zealand model by reading about it in the media, in Canadian digests of New Zealand policy, and, most importantly, via *Towards Prosperity* [Douglas and Callen, 1987], which provides an account of the early budget, deregulation, and corporatization efforts. Both Roger Douglas and a New Zealand bureaucrat who had dealt with municipal reform came to talk with politicians and senior officials about what to do and how to do it quickly. Much of the New Zealand experience was distilled into aphoristic statements deployed by bureaucrats and politicians both publicly and privately.

New Zealand had a more profound intellectual impact through the Alberta Financial Review Commission (FRC). The FRC had an easy time borrowing a coherent policy package based on New Zealand's reforms. The report of the FRC [1993] is the functional equivalent of the New Zealand Treasury's election briefing papers. The report identifies and rails against management pathologies, poor information flows, mandate creep, and poor accountability, and then calls for institutional changes paralleling those in New Zealand to control these problems. Just as in New Zealand, for example, the FRC aggressively recommended the use of accrual accounting to make the government's budget and asset balances transparent and to force dramatic changes in budgeting behavior.

Finally, "New Zealand"—that is, a stylized understanding of the New Zealand model—had significant political effects. A well-known television documentary on New Zealand's retrenchment/reorganization was shown at the public "roundtables" Klein used to sell fiscal retrenchment in 1993. Phrases like "hitting the wall" became common, and the government's business plans explicitly echoed Douglas's 1980 wish list, *There's Got to Be a Better Way*, taking the titles *A Better Way* and *A Better Way II* [Government of Alberta, 1994, 1995].

Changing Politicians' Behavior

As discussed earlier, one of the most distinctive features of the New Zealand model is its effort to change individual behavior by changing the institutional context for that behavior. This effort extends to politicians as well as to public sector employees and their "customers."

In New Zealand, both Labour and National controlled their own politicians by exploiting the absence of a written constitution to run "elected dictatorships" [Palmer, 1979]. Because Labour members of Parliament were sworn to abide caucus and cabinet decisions, a small core of cabinet members could leverage their power to control the entire Labour bloc [Nagel, in press]. Labour reinforced this by setting up a Cabinet Policy Committee, dominated by the finance ministry, which sat at the apex of a set of issue-oriented committees, and vetted their spending requests. National changed this structure slightly but without diluting central control over spending.

Labour also legislated discipline by giving the Reserve Bank a new organic statute committing it to price stability and freeing it from responsibility for monetizing the government's deficit. National's Fiscal Responsibility Act (1994) made it harder for future governments to overspend. This act, which strongly influenced similar legislation in Alberta, mandates publication of fiscal data based on generally accepted accounting practices year-round, the use of benchmarks so the public can assess these data, and the publication of a budget statement well in advance of the actual budget in order to prompt public debate over the budget's goals. As in Alberta, the idea is to divert operating surpluses to debt reduction, to balance the budget over the economic cycle, and to boost public sector net worth. The law implicitly suggests that politicians cannot be trusted, which is not surprising given the intellectual foundations of reorganization in New Zealand under both Labour and National.

In Alberta, the Klein administration also reorganized government, particularly the cabinet system, to reduce politicians' temptations to rally constituents in defense of spending levels. Before Klein, ministries had proliferated to the point where nearly one-third of the legislature held some ministry. Interviews suggest that ministers quickly became advocates for their departments' budget share, as politicians competed for media exposure and votes by delivering the greatest volume of cash, clinics, or schools to their clients and constituents. Line-item budgets with built-in inflation and volume allowances allowed ministers to expand spending effortlessly, even under Getty's more austere budgets.

As the Klein administration strove to cut spending absolutely, not simply limit growth, it had to reverse this behavior. Klein disciplined budgeting by restructuring the cabinet and the ministries. Klein cut the number of sitting ministers to 16, and then grouped them by function under four Standing Policy Committees (SPCs). The SPCs are chaired by backbenchers, SPC membership is open to any PCP backbencher, and majority vote prevails. Because many Members of the Legislative Assembly (MLAs) were newly elected on promises of spending cuts and no tax increases, they had an incentive to scrutinize department budgets and force cuts in order to be able to claim to voters that they had delivered on their campaign promises; on the other hand, because they were not ministers, they could not claim credit for delivering pork. The SPC structure allows backbenchers to gang up against specific ministers to force them to stick to their business plans and to cut apparently marginal programs. In effect, Klein isolated ministers as spenders, converted backbenchers from individuals all seeking a share of the pie to a group with a common interest in disciplining spenders, and reinserted ministers as watchdogs on other ministers through their participation in the SPCs that did not monitor their own particular department. The SPC system significantly enhances the power of the finance minister as only Treasury has the right to vet the fiscal implications of business plans; one Treasury interviewee said bluntly that all this stiffened their spines in budget talks.

As in New Zealand, Klein also used deficit and debt retirement legislation to control both politicians and constituents. Like National in New Zealand, the Klein government legislated an orientation toward budget cutting and transparency. The Deficit Elimination Act (DEA) (1993) required a balanced budget by fiscal year 1996–1997, forced the government to publish its quarterly accounts in a timely fashion, and required departments to account for budget overruns and to demonstrate a plan for attaining balance. More pointedly, the DEA obliged the Treasury to forecast resource revenues using a five-year rolling average, which prevents politicians from indulging in rosy-scenariosis and dampens the real effects of resource revenue volatility.

Similarly, the Balanced Budget and Debt Retirement Act (BBDRA) (1995) requires a straight-line amortization of Alberta's debt over 25 years, with any unforeseen budget surpluses going to larger principal repayments. It also imposed the five-year rolling average rule on forecast corporate tax revenues and set the new forecast limit at 90 percent of average corporate and resource revenues [Boothe, 1997]. As in New Zealand, all of this makes any departure from budget-cutting routines highly visible, exposing politicians who propose spending increases or try to shift the burden of taxation to public censure. Because the Alberta Taxpayer Protection Act (1994) requires a referendum in order to introduce any sales tax, and with DEA and BBDRA protocols typically understating resource and corporate revenues, any requests for additional spending have to be matched with visible and thus politically dangerous requests for income tax increases.

Changing Individuals' Behavior

Reformers in New Zealand and Alberta tried to change individuals' behavior along with that of politicians. As Alberta's finance minister put it, they want to create a "new normal," and in this respect they are no different from finance ministries elsewhere [Savoie, 1994; Schwartz, 1994a]. In both New Zealand and Alberta reformers created a new normal by introducing markets or quasi-markets for public sector goods and services.

In New Zealand Labour did the most to change the public sector. It privatized the bulk of the state's internal producers of commercially available goods and services, which by the early 1980s accounted for about 12 percent of GDP. National continued this, selling a few high-value but sensitive firms. Relative to the economy, New Zealand's privatizations were three times those in Britain.

In core public services like health, education, and welfare Labour attempted to inroduce markets or quasi-markets. They separated the roles of service producer and financer, introduced private-sector-style wage discipline on workers, judged management on output and performance-based criteria, and decentralized operational autonomy (but centralized control over fixed agency budgets). The job of providing policy advice was separated from the provision of policy outputs. In effect, agencies were told and allowed to produce services in an efficient and consumer friendly way, but without any ability to claim additional budget resources. Labour also introduced user fees and a more flexible labor relations regime in 1989 [Boston et al., 1991; Schwartz, 1994a]. Although Labour's white papers foreshadowed a complete reorganization akin to that in the goods producing sector, it fell to National to carry out the bulk of this restructuring. National escalated and accelerated the shift toward markets in all these core areas. However, aside from the labor market, National's policies for the public sector did not break dramatically with any of those introduced by Labour. National's (Logan) Review of State Sector Reforms essentially said: "Good ideas, now implement them thoroughly."

In health, for example, National broke the health system into four Regional Health Authorities which contracted out for the services they thought necessary. Primary care physicians and about 25 Crown Health Enterprises (former hospitals) provided these services, competing for "consumers" who had the right to seek services elsewhere, and paying dividends and interest on the "capital" they borrowed from the state. A rising scale of user charges was imposed on parts of the health care system, and private providers were permitted to enter the market.

National similarly inserted markets into the public housing arena, dividing the state housing agency into a mortgage provider and a property management firm, progressively raising rentals to market levels, and partly compensating for the lost subsidy by introducing a housing benefit. In education National has tried to impose "bulk funding," a capitation-based block grant for both primary and tertiary education. Parent-dominated school boards and university administrations could then compete for students, pay teachers individually calibrated wages, and offer services tailored to their "market niche." In all this, though, National is essentially carrying out the program Labour established in the late 1980s, and where it has been forced to retreat—as in health—it typically falls back to Labour's program.

What happened in Alberta? Relative to New Zealand, the Klein government gave priority to cutting spending rather than to public sector reorganization. Klein's team saw spending cuts as a way to force government to become more efficient, rather than seeking reorganization itself as a path to lower spending. Klein also has not moved quite as quickly as New Zealand Labour did after 1987.

However, what is being done is clearly in the New Zealand mold in terms of means and ends. As in New Zealand, public sector reinvention means imposing wage discipline on workers, letting managers manage for results, flattening hierarchies, and introducing competition. In terms of results, the Klein administration has been more successful in the last three areas than in the first.

Although the Klein government was able to extract an average 5 percent across-the-board wage cut from public sector workers (including noncivil service employees in health and education), it has not yet gotten substantive change in work rules. A productivity-based bonus of up to 10 percent of wages was offered in 1995 under the "Productivity Plus" program. However, the Alberta Union of Public Employees (AUPE) rejected this effort at differentiated pay, so it affects only about 15 percent of the civil service, almost exclusively management.

More significant changes have come from the delegation of operational authority to agencies given strictly fixed budgets, which again is clearly in the New Zealand mold. All agencies and departments have been forced to generate three-year "business plans" since the 1994 budget. Like the contracts employed in New Zealand, these plans must detail agency goals, the means to achieve these goals, and the ways goals will be measured. Treasury gave up the dubious power to micromanage agencies in return for control over aggregate budgets, decentralizing personnel and purchasing power to line agencies [Boothe, 1997]. This allows the Treasury and political leadership to give agencies a fixed (and shrinking) budget, without having to worry about how agencies will cope with budget cuts and still deliver the same volume of services. The business plan process is well institutionalized, but interviews indicate that performance measures are still rather crude and undeveloped. Most attention is still focused on the bottom-line budget outcome. The most basic performance measures were not promulgated until early 1995 [Alberta Treasury, 1995b].

Specific service producing agencies were also put into competition with each other, just as in New Zealand. In both education and health, hierarchies were flattened in a search for administrative savings. For example, roughly 200 independent hospitals were grouped into 17 Regional Health Authorities (RHA), and 141 school boards were consolidated into 57 without creating new administrative levels. Treasury would prefer view even fewer units (and levels) of administration in education and health. Both RHAs and schools in principle now compete for patients or students and are rewarded on a capitation basis.

Basic education provides the clearest example of the introduction of markets. The province took control of the tax base for basic education by centralizing the property tax and limiting local taxes. Property tax revenues now flow to the Ministry of Education and then go back to schools on a mostly capitation basis; about 75 percent of funding is capitation-based versus about 33 percent pre-reform [Kneebone and McKenzie, 1997]. Schools compete with each other for students on quality grounds, not on the volume of spending. The education ministry limits nonschool administrative costs to 4 percent of local budgets, and mandates that 88 percent of budgets must go to instructional costs. Charter schools are permitted though few have started. In principle, then, a market for students now exists in which quality, specialization, and location differentiate providers.

CONCLUSION: WHY ARE THERE DIFFERENCES, AND WHAT DIFFERENCE DID NEW ZEALAND MAKE?

The contrast between Alberta and New Zealand suggests three interesting things. First, it shows that the New Zealand model is exportable in terms of its hortatory and heuristic functions. For the faint of heart—particularly politicians—it demonstrates that change is possible, and it provides them with a set of useful slogans, principles, and ideas. Heuristically, the New Zealand model has been assimilated by other financial ministries. Both in Alberta and elsewhere they have not been shy about putting forward policy recommendations based on this model [Kelsey, 1996; Williamson, 1994]. The concrete and particular interests that coalesce behind any party's attempt to reorganize government probably will matter more for how that program is fleshed out, but the model provides the skeleton for that flesh.

The second interesting thing, that differences among parties' social bases matter, is not particularly startling. What is interesting is the way that those social bases differentiated the essentially similar policy advice emanating from the fiscal bureaucracy. Although fiscal bureaucrats in each society had identical outlooks (discussed earlier) each party chose the most politically convenient path. New Zealand's Labour government was somewhat constrained in its ability to attack public and even more so private sector unions by their weight in the party's electoral calculations and internal organization. Labour also needed to retain the support of welfare state beneficiaries. Therefore, it sought to transform the welfare state in order to save it; it hoped that a more efficient public sector at the same level of funding would be stronger than an inefficient public sector with greater funding.

The constraints on Klein's PCP ran in the opposite direction. Put simply, PCP policies aim at rewarding its corporate sponsors with permanently low taxes despite the costs of their prior failure at state capitalism. Consequently, spending cuts dominated the drive for fiscal balance in Alberta instead of the reinvention that dominated policy in New Zealand.

More specific effects of partisan social bases can be seen, albeit with some difficulty, in the degree to which the policies they actually implemented deviated from those espoused by the bureaucracy, and in particular the financial bureaucracies. Both sets of bureaucrats had agendas for reform predating the elections and "crises" that facilitated policy reversals [Lisac, 1995, pp. 48–50; Kneebone and McKenzie, 1997; Schwartz, 1994a; author interviews with Alberta Treasury staff, 1996 and New Zealand Treasury staff, 1988, 1991]. And both sets of bureaucrats expressed, if sometimes in guarded ways, preferences for policies deviating from those championed by politicians.

Alberta's financial bureaucrats, for example, certainly prefer the current effort at fiscal balance to running more deficits. They had desired more conservative budgeting forecasts since oil prices plummeted in 1986. At that time Treasury bureaucrats had pushed for and received $1 billion in tax increases to offset falling resource revenues, and had also gotten a politically unpopular 3 percent cut in spending. When oil prices rebounded slightly in 1987, politicians chose to use optimistic oil price forecasts and thus contributed to even larger future deficits when the secular slide in oil prices continued. Treasury wanted conservative revenue forecasting to control politicians' tendency toward optimistic budgeting and got this from the BBDRA. But the same BBDRA that mandates conservative forecasting also mandates amortization of Alberta's current debt. Treasury bureaucrats believe that a lower and fiscally sustainable level of debt is acceptable and see becoming debt free as a politically, not economically necessary goal.

A similar dynamic occurred in primary education. The education ministry had long desired a rationalization of school boards and unitization of the property tax base to equalize education funding. Politicians used unitization to eliminate a property tax on machinery and equipment that fell hardest on small oil drillers and large resource processors in rural areas, while helping out poorer rural school districts. All are among the PCP's core constituencies. The PCP's need to satisfy its rural and business constituencies, or to make painful cuts politically palatable, moved politicians to overrule or modify bureaucrats' preferences.

New Zealand's bureaucrats were also rebuffed when they threatened Labour's core constituencies too much. Treasury efforts to deregulate the labor market in 1986 failed when unions mounted concerted opposition inside and outside the Labour party. Treasury efforts to stifle a Royal Commission on Social Policy whose report might strengthen the welfare state failed. And proposals for a flat income tax created the 1988 crisis that led to Roger Douglas being sacked as finance minister. Nonetheless, Labour and private sector labor unions accepted Treasury efforts to reorganize the public sector in order to save what was possible. Treasury had to wait for the National administration to enact wholesale change in the labor market and other social issue areas. In both societies political parties set limits on bureaucrats, and the differences between those limits determined the different paths each country took to fiscal balance.

Do these differences matter in more than trivial ways? Although it is too early to tell, the third interesting thing flowing from the comparison of New Zealand and Alberta concerns the relevance of different theories of bureaucracy to the problem of fiscal retrenchment. Econometric analyses differ on the best path to sustainable fiscal balance. In a 1995 paper, Harvard economists Alesina and Perotti argued that only cutting "two expenditures—government employment and social programmes—often regarded as untouchable by policy-makers and their advisers," led to permanent fiscal improvement; raising taxes had nugatory effects [Alesina and Perotti, 1995, pp. 205, 226]. But two Canadian economists came to the opposite conclusion when they studied fiscal adjustment in Canada and its provinces [Kneebone and McKenzie, 1996].

Without entering into the debate about significance levels and the assumptions built into these models, we can safely say that, like most econometric analyses, both of these elide the specific mechanism(s) that produce the outcome they found. These mechanisms are of greater interest than the raw correlations because they deal with the sustained institutional changes that finance ministries believe are needed to lock in fiscal balance. Put simply, is it better to reorganize first, and cut later, as New Zealand's Labour (and in most ways National) did, or is it better to cut first and reorganize later, as Alberta's PCP did? Put in theoretical terms, is Simon or Niskanen right?

Herbert Simon [1945] has suggested that slack exists in organizations in order to facilitate change. For Simon, de jure authority inside agencies actually translates into a de facto zone of acceptability surrounding work norms. When agency heads need to make changes that violate the zone of acceptability, they use slack (extra resources) to buy off internal opponents and losers. For Simon these extra resources are what enable change in bureaucracies.

Terry Moe makes a parallel argument that politicians like to create autonomy for agencies because it enables them to shift the blame and reduces the risk that an opposition party that regains power will be able to use that agency for its own purposes [Moe, 1990]. Autonomy creates the potential for slack, because no agency can be so closely monitored as to prevent its "agents" from abusing their principals by virtue of their position. But at the same time, slack also enables politicians to intervene from time to time on behalf of their constituents. Therefore, although slack may be economically inefficient, it is politically efficient. Together, Simon and Moe sketch out a chain of principal–

agent relations in which some degree of slack eases the frictions attendant to any change.

In contrast, Niskanen suggests that agency heads tend to maximize slack, and will always protect slack and cut essential programs in times of austerity. Niskanen treats bureaucracies as unified actors protecting their resource allotment. In this vision, the only way to get change is to cut so deeply that managers are forced to purge departments of all nonessential activity. Simply maintaining the budget and changing the rules will not produce changes within agencies. Rather, change comes about only in times of severe environmental stress, because putting departments into a budget crisis exposes latent coflicts inside departments. It pits would-be reformers, who try to save the agency (from) itself, against those seeking only to defend entrenched practices and spending that in effect constitute the slack embodied in the budget. (Defenders of slack, of course, respond to budget cuts by systematically disinvesting; they live off the agency's accumulated capital.)

New Zealand and Alberta thus present an unfinished test of these competing visions of the bureaucracy. Both policies seek to constrain what they see as self-regarding agents by subjecting them to market pressure. But in New Zealand budgets were mostly balanced upwards by raising taxes, and government was reinvented by changing the rules of governing behavior in the public sector. Labour accepted a continued rise in debt and risked some crowding out of social spending by debt service in the hope that a revived public sector would deliver offsetting efficiencies. National avoided sustained cutting, but used markets even more systematically to discipline the public sector, assuming that markets would reduce slack to the "normal" levels found in the private sector [East, 1995].

In Alberta budgets were balanced downward and government reinvented by putting agencies in crisis. The PCP abjured rising debt and risked cutting complex systems of service delivery so deeply that these systems might no longer function effectively. It also hoped that these cuts would so revive the public sector that efficiency gains would make them functional despite cuts.

In a few years we will be able to see which path to public sector efficiency is better, and presumably which vision of the bureaucracy is more accurate. So far New Zealand's public sector has continued to function, and while New Zealand under Labour accumulated some public debt over part of its tenure, National used relatively small expenditure cuts to create a large enough primary surplus to reduce the relative size of the public debt after 1993.

In contrast, it remains to be seen if Alberta's public sector can survive and adjust to Alberta's rapid attainment of a large structural surplus. The public sector may simply be living off its accumulated capital. The recent reversal of some cuts in the health budget in part reflected rising public fear that cuts were eroding the quality and quantity of health care. This echoes the private sector's recent experience with reengineering and downsizing, where a growing number of analysts believe that downsizing is not a path toward long-term efficiency ["Making Companies Efficient," *Economist*, 1996].

This contrast suggests that the sequencing of reforms is important because partisan selection from the range of plausible policy options has significant consequences besides the obvious distributional ones. Neither path may be the only perfect way to eliminate deficits. Left governments' willingness to raise taxes in their search for a more efficient public sector may not assure long-term fiscal stability, because of the continued short-run accumulation of debt. This is quite clear from the experience of New Zealand's trans-Tasman cousin, Australia, which through 1996 pursued a much gentler form of government reorganization involving more consultation with public sector unions, less retrenchment, and much greater concern for the short-run employment consequences of policy. Australia continues to run significant structural budget and current account deficits.

Right governments' search for short-term fiscal balance so as to reduce taxes may sacrifice the welfare state's ability to generate the administrative reforms needed to assure long-term fiscal stability. This is quite clear from Canada's southern cousin, the U.S., where welfare reform has created even greater demands for cash, and where efforts at a balanced budget alone seem unlikely to produce the kind of public sector revitalization needed to cut costs in the long term. Transferring programs wholesale to the states and making blunt cuts in spending in an environment in which government has no legitimacy seems just as likely to produce increased social pathology with all its associated costs.

The most significant lesson that can be transferred from the New Zealand model, then, is that neither cutting nor taxing are ideal paths to fiscal adjustment, and that public sector renewal and reorganization is important to the long-term fiscal balance. New Zealand and Alberta's contrasting efforts to balance budgets and reinvent government suggest that left governments in general are probably more likely to pursue and succeed at the reinvention of government, while stinting fiscal balance, and that right governments are more likely to achieve short-run fiscal balance at the expense of successful reinvention. In turn this suggests that neither the Left nor the Right has an ideal policy mix for long-term fiscal stability. Ironically, an alternation of governments may provide the best policy mix.

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