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Public sector reforms and sovereign debt management: Capital market development as strategy?

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A R T I C L E I N F O

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A B S T R A C T

The reform of sovereign debt management has largely escaped attention in the accounting literature on public sector financial management reforms. The application of business thinking to the public sector has meant conceptualising the sovereign debt management function as a corporate-style controller function, applying to sovereign debt management the asset and liability management techniques developed in the banking sector. Accruals-based appropriations and outcomes-focused strategy statements weaken a legislature's power of control over the executive government and divert attention from the control of public finance, which increasingly appears to be delegated to the executive government. Wider application of the asset and liability management techniques adopted for sovereign debt management seems to support an emergent capital market development strategy, facilitated by increasing government participation in capital markets. The New Zealand government's financial statements help to illustrate these developments and show the extent of government participation in capital market activities involving large amounts of public money and leveraging of public assets. Financial control and accountability is not achieved by relying on strategy statements, objectives and *ex post* review.

In the liberal economic system of the late 19th century, capital markets were thought benign, and a government's role perceived as supporting capital markets in crisis conditions (Eichengreen and James, 2003). Neoliberal reforms since the late 1970s sought to restore a capital markets-centred economic system, but early expectations that this neoliberal system would be self-correcting have proved unfounded, provoking controversy about the nature of the system (Ocampo et al., 2008; Pauly, 2009; Stiglitz, 2008; Tabb, 2003). Internationally, governments' support for capital markets at the height of the capital markets crisis in 2008 drew public attention as governments contributed public funds to relieve the crisis. There has been less public attention to the extent of ongoing government support for, and participation in, capital markets both before that crisis and continuing today. That is the focus of this article.

Dodd (2008) identifies four key components of capital markets: securities markets (issuing and trading bonds and equity shares), the banking industry (issuing loans and providing payment and settlement services), institutional investors such as insurance and pension funds (providing future income and collateral for lending), and derivatives markets (offering risk management and price discovery). Capital markets were a key source of sovereign debt by the late 1970s when neoliberal reforms emerged, but there was even then interdependence between governments and capital markets. The ready availability of sovereign debt securities is important to capital markets – institutional investors use sovereign debt securities for portfolio balancing purposes; the banking industry uses them for meeting capital adequacy requirements; and they are

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also used for other purposes such as for pricing various financial instruments, including innovative derivative instruments (OECD, 2003). Through the reform of sovereign debt management as part of public sector reforms, government support for, and participation in, capital markets has extended significantly.

New public management-style public sector reforms pursued within the neoliberal reforms have their roots in the United States, but have proceeded further in Westminster parliamentary countries, such as the UK, Australia and New Zealand (Jones, 2012). New Zealand's international leadership in these financial reforms is well known (Boston et al., 1991; Jones, 2012), but the reform of sovereign debt management, although mentioned (Newberry and Pont-Newby, 2009; Pallot, 1991) has largely escaped research attention, both in relation to New Zealand, and internationally.

This article examines that sovereign debt management reform in New Zealand, making three contributions to the accounting literature on public sector reforms. First, in focusing attention on sovereign debt management and the techniques involved, this article identifies governmental financial system developments and activities proceeding via delegated powers that involve very large amounts of public money, the leveraging of public assets and a deepening government immersion in capital markets. Second, this article builds on Jones' (2012) explanation about the peculiarities of the Westminster parliamentary system. In New Zealand's Westminster-style system, parliament's involvement in financial control of the executive government is minor, while the Treasury functions as a corporate-style controller via powers delegated to the Minister of Finance. The financial management reforms deflected parliamentary and public attention from those ongoing financing activities, which have since expanded into extensive capital market activities. Thirdly, this article draws attention to international public management material that identifies changing thinking about sovereign debt management, and the techniques involved. Admittedly, this information is incomplete, but it may assist other researchers to examine developments in their own country.

The next section of this article provides an overview of the public sector reforms pursued within the broader neoliberal reforms, noting in particular the importance of strategy statements, objectives and *ex post* performance measurement. The research literature about strategy is discussed, and the research method explained. The subsequent section outlines the business-oriented approach to financial management reforms, drawing attention to the reform of sovereign debt management. Section 3 summarises New Zealand's public sector financial management reforms, providing the context for describing New Zealand's sovereign debt management reforms and the subsequent extension of the techniques involved to all assets and liabilities in the government's financial reports. This is called "balance sheet management." Material from strategy statements, policy discussion papers and the New Zealand government's financial reports from 2002 to 2012 helps to illustrate these developments to show the growing involvement in capital market activities, and some of the public rationales. Section 5 summarises briefly the phases of development, noting that the strategies emphasised to the wider public are not necessarily the same as those discussed in other documents, or are emphasised differently. The conclusion summarises the three contributions to the accounting literature, and suggests future research directions to further understand international developments.

1. Public sector reform model: strategy

1.1. Literature review

Neoliberal reforms at the macro-economic level have prompted governments internationally to surrender significant economic powers, effectively to capital markets, by removing restrictions on the international flow of capital. Consequently markets set exchange rates, with central banks distanced from government influence, yet authorised by them to set interest rates (Tabb, 2003). These changes have helped to facilitate restoration of a capital markets-centred economic system via "trade and financial liberalisation, privatisation, deregulation, openness to foreign direct investment, a competitive exchange rate, fiscal discipline, lower taxes and smaller government" (Tabb, 2003, p. 27).

The public sector reform component of neoliberal reforms includes fiscal discipline to limit government deficits and debt, especially in relation to GDP. Lowered taxes prompt government expenditure reductions by reprioritising expenditure from areas that "receive more resources than their economic returns can justify . . . towards neglected fields with high economic returns and the potential to improve income distribution" while government operations and assets are privatised (Kelsey, 1995; Williamson, 1994, p. 26).[1] More detailed public sector restructuring and reforms have drawn heavily on commercial thinking and techniques imported from the business sector (Watkins and Arrington, 2007).

Strategy and strategic planning are key features of these public sector reforms. Governments internationally have adopted broad vision statements, identified objectives to pursue, and some are budgeting accordingly, using accrual budgeting. Attention is directed to *ex post* measurement of performance towards achieving these objectives.

The emphasis on strategy and *ex post* performance measurement suggests deliberate and systematic strategy development, comprehensiveness, and clarity about the strategies pursued. However, deliberate strategy development is always accompanied by emergent strategies, whereby actions, possibly without clear intentions, "simply converge into patterns" (Mintzberg, 1987, p. 66). A focus on deliberate strategy development is, therefore incomplete. Also, especially in a

[1] The "supply side" thinking underpinning the tax reductions combined with government expenditure reduction/reprioritisation is known pejoratively as "trickle down" theory.