

Does Economic Reform Mean Pain?

Writing in the *Dominion Post* around the time of the release of the taskforce report on catching up with Australian income levels by 2025, prime minister John Key said, “Neither do New Zealanders need or want the government to embark on a hugely radical, disruptive policy agenda.”

The implicit reference is to New Zealand’s painful economic reforms of the 1980s and early 1990s. But do they bear comparison with what is needed today to catch up to Australia?

First, neither the earlier reforms nor the prescriptions of the 2025 Taskforce or the OECD can fairly be described as radical.

As Martin Wolf of the *Financial Times*, perhaps Britain’s leading economic commentator, wrote, New Zealand’s [1980s] reforms “were radical only by the standard of New Zealand’s incompetent past ... It is simply wrong to describe such reforms as delivering a laissez-faire paradise. ‘Improved, but could do even better’ would be a far more sensible assessment.”

Yet when the OECD released its most recent report on New Zealand in April 2009, *Herald* journalist Brian Fallow repeated the error: “An OECD report highlights problems facing the economy and proposes some radical solutions.”

The last thing the OECD could be accused of is being radical. It reflects the mainstream views of its member countries. Many of the 2025 Taskforce recommendations were in line with OECD advice.

Second, how should we think about the ‘disruption’ issue?

There is no doubt that the 1980s reforms were painful for many people, particularly through the rise in unemployment.

But it should be remembered that unemployment was rising prior to the reform programme, and that without it New Zealand might have

experienced the sort of economic crisis that Greece and other European countries are facing today. The unemployment rate in Spain's rigid labour market is approaching 20%.

Many people think of the rise in unemployment as primarily due to restructuring policies such as reducing manufacturing industry import protection and putting state-owned enterprises on to a commercial basis.

Those were undoubtedly factors, but probably more important were the moves to rein in inflation. Disinflation caused steep rises in unemployment in most OECD countries in the 1980s as wages outstripped falling inflation.

In New Zealand, trade unions pushed for big wage increases after the wage freeze ended – nominal wages rose by 20% in the year to September 1986. This was a massive 12% real wage shock which sharply increased unemployment.

In addition, unions blocked efforts to free up the inflexible labour market. Blame Ken Douglas, not Roger Douglas, for greatly worsening the unemployment pain.

The situation today is quite different. Inflation is well anchored, import licensing is gone and tariffs are low, and even privatisation of SOEs would have few implications for jobs.

So how much disruption would adopting the 2025 Taskforce recommendations involve?

Some have focused on the recommendation to wind back central government operating spending to the 2004 share of GDP, suggesting it implies a cut of some \$8 billion.

This is mistaken. As the Taskforce chair Don Brash has pointed out, with real annual economic growth of just 3% and inflation of 2.5% over the next few years, the spending ratio would fall to 29% of GDP – the 2004 level – with government spending simply held constant.

And while cutting wasteful government spending could involve job losses in the public sector, it would facilitate employment growth in the private sector, particularly in internationally competing industries.

A raft of other recommendations – scrapping the Cullen Fund and KiwiSaver subsidies, enacting a Regulatory Responsibility Bill, reviewing the Resource Management Act and the Commerce Act, establishing a system of tradeable water rights and many others – scarcely involve disruption.

Other key recommendations such as raising the eligibility age for New Zealand Superannuation, welfare reforms to encourage people to move off benefits and into work, and employment law changes to facilitate job creation would hardly require draconian adjustments and are imperative if New Zealand is to grow and raise living standards.

Overall, a programme that put New Zealand on a path to catching up to Australian incomes would yield massive benefits relative to any adjustment costs.

In many ways the Taskforce proposals would merely bring New Zealand into line with Australian policies. Moreover, Australia is an aspirational country that hasn't stopped reforming; we are chasing a moving target.

A recent *Herald* editorial stated, "Arguably, the country could afford the decade of stasis" of the Clark-Cullen years. Really! Is the *Herald* comfortable with economic growth of only around 1% a year in the Labour government's last term, the current unemployment rate of 7.3%, a youth unemployment rate of 26.5%, and budget deficits as far as the eye can see?

Stagnation is what produces real pain, reform deferred is pain multiplied, and one shudders to think what another decade of stasis would produce.

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