

This article was first published in the *Otago Daily Times* on 23 May 2008

In Economics It's the Long Run that Matters

“In the long run”, economist John Maynard Keynes said, “we are all dead.”

To which the best reply is, “Yes, but some of us have children.”

Keynes was cynically dismissing the long-term consequences of economic policy decisions. He brought a short-term focus to economics, associated in New Zealand with the economic ‘fine tuning’ of the Muldoon era.

But it is the long term that matters for increases in material standards of living for most people.

On current trends, average per capita income in New Zealand is growing at about 1.5% a year.

In the decade 1992-2002, per capita income grew at around 2.6% a year on average, according to Statistics New Zealand figures.

Over a working lifetime (say 40 years), this difference is substantial. At an annual growth rate of 2.6%, per capita income nearly trebles; at 1.5 % it does not even double.

Raising New Zealand's per capita GDP growth rate to 2.6% in the 1990s from around 1% a year in the 1980s required major and difficult economic reforms.

Moreover, the programme which began in 1984 took until around 1992 to pay real dividends.

Unemployment could have been much lower and the payoff somewhat earlier if the overall programme had been more coherent, for example if the labour market had been freed up earlier.

But there was no escaping the long period of time needed to move the economy from a low-growth trajectory to a higher one.

The Business Roundtable broadly supported the reforms but many people were sceptical that they would ever pay off.

In 1991, 15 economists from the University of Auckland claimed that moves that year to rein in government spending and free up the labour market would worsen the recession.

Instead, they paved the way for strong economic growth and large falls in unemployment, interrupted only by the brief downturn during the Asian economic crises of 1998.

Some eight years therefore elapsed between the beginning of the introduction of better policies and the appearance of major rewards – and it took even more time for a consensus to develop that they were sound and necessary.

When the Labour-led government came into office in late 1999, the economy was recovering strongly from the Asian recession and for the next few years the economic momentum was maintained, buoyed by the sound economic fundamentals, relaxed monetary policy and strong external terms of trade.

But as early as 2000, warnings were being sounded about the government's policy directions.

Business Roundtable chairman Ralph Norris gave a speech entitled "Can New Zealand afford to replay the economic past?" He suggested that many of the government's announced policies – increases in government spending and the top tax rate, re-regulation of the labour market, restoration of the ACC monopoly, new industry subsidies, intervention in network industries and much more – would take New Zealand backward, not forward.

Further down the track we have seen the renationalisation of several industries, endlessly expanding nanny state regulation, a raft of distorting tax measures, and many redistributive programmes, offset only by a few pro-growth initiatives such as the free trade agreement with China.

As Ralph Norris noted, “What seems to have been forgotten about virtually all of these policies is that New Zealand applied them in the past and they did not work.”

Inevitably, it has taken a long time for bad policies to take their toll – economic performance does not change quickly, and many of the former policies have been maintained. But eight years down the track we can see that the economy has reverted to a mediocre level of performance.

The clearest indicator of the damage is the slump in productivity growth, which has more than halved from the trend rates of the 1990s. So much for the government's goal of returning living standards to the top half of the OECD.

As well, households are under pressure from price increases, employment growth is tailing off and outward migration is rising, central and local government spending and regulation is stifling the productive sector, and the current account deficit is large.

New Zealand's directions this decade have been significantly at variance with those of Australia and other countries that have continued on a liberalising path.

Last week's budget in Australia forecast ongoing growth in that economy of close to 3% in the coming year, whereas New Zealand may be lucky to achieve half that rate.

New Zealanders are likely to look back on this decade as a period of mediocrity, unjustified complacency, irresponsible spending, lost opportunities and backwardness in comparison to the dynamism in many parts of the world.

Rather than ‘last, loneliest and loveliest’, we seem to have become lost, loneliest and listless.

What's more, it will take time again to change speed and direction. We must hope that whatever government is in office after the election recognises the need to vigorously pursue much higher quality policies.

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