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**HIGH ACHIEVERS OR TIMID GRADUALISTS?
THE AUSTRALASIAN DILEMMA**

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HIGH ACHIEVERS OR TIMID GRADUALISTS?

It is a very great honour to be invited to give this address. It's also a pleasure to be in the company of many good personal friends and good friends of New Zealand. I want to pay a special tribute to Maurice Newman whose contributions as chairman of the Centre for Independent Studies for many years have been of great value to New Zealand. As chairman of the Australian Stock Exchange he has already played a very constructive role in strengthening relationships between our two stock exchanges and investment markets.

I have been asked to offer a New Zealand perspective on what has happened in both our countries over the last ten years or so, and to reflect upon what might happen in the foreseeable future.

The first, obvious, but nonetheless important starting point for any Kiwi speaking in Australia is to refer to Sir Henry Parkes' great metaphor at the federation conference here in Melbourne in February 1890, when he spoke of "the crimson thread of kinship." New Zealand took part in that conference but after 1890 New Zealand interest in joining in a federal structure of nationhood waned. Geoffrey Blainey suggests that one of the reasons for New Zealand disinterest was that in the 1890s New Zealand per capita incomes were higher than Australian incomes, particularly Victorian incomes, and that New Zealanders feared that their taxes would be used to subsidise the other colonies. Whatever the reason, the only legacy of those discussions today is Section 6 of the Australian constitution which guarantees a place for New Zealand in the Australian federation if New Zealand ever asks for one.

Many Australians thought that outcome was becoming imminent, not out of choice but of necessity, as they watched New Zealand governments embark on a seemingly unending rake's progress through the 1970s and early 1980s. From being one of the world's high income countries at the turn of the century, a position it maintained until the 1950s, New Zealand was going steadily downhill. By the early 1980s, we were no longer in the top 20, we had accumulated a mountain of debt, and the fall was becoming more precipitate.

The twentieth century history of both our countries owes much to the influence of socialism, the dominant political ideology of the century. Socialist ideas gained currency in the Antipodes before anywhere else in the English-speaking world. In New Zealand, before the Great War of 1914-18, "socialism without doctrine" became

the watchword, and in Australia "state socialism" was explicitly implemented by conservative governments at the State as well as the Federal level.

What we might call "pragmatic socialism" led governments in both countries to become the owners (often monopoly owners) and operators of railroads, telephone systems, postal services, electricity supply networks, ports and airports, forests and forestry industries, water supply and sewerage systems, primary and then secondary schools, hospitals, abattoirs, gambling facilities, radio and television networks, airlines, shipping lines, insurance companies and banks. (This is not a complete list but it illustrates the point.)

Collectivist ideas permeated many other Australasian economic institutions. They were clearly manifest in our labour market regulations, in the erection of tariff walls and in the statutory marketing arrangements for primary products. The boundaries between the government and the private sector became blurred at an early stage. A business culture emerged which saw state intervention not as a threat but as a potential benefit for business. The president of the Associated Chambers of Commerce in New Zealand told his members in November 1934 that businessmen "should to some extent accept the tendency towards State control ... and should themselves participate in it." The blossoming of import controls, tariffs and subsidies over the following thirty years indicates they were not slow to follow this kind of advice.

In New Zealand such ideas achieved an unchallenged dominance, politically and intellectually. By the 1960s we were into various forms of indicative planning. In Australia, socialism was to a greater extent held at bay for most of the post-war period by the Menzies governments. Only under Whitlam was there a brief fireworks display of socialist confidence. With the worldwide collapse of socialism in the 1980s and early 1990s, that confidence has largely evaporated. Yet in both our countries there is still resistance to ideas such as privatisation, despite the overwhelming practical evidence of the superiority of private over state enterprise. This can be traced in part to atavistic attachments to the credo of "public ownership of the means of production, distribution and exchange."

The result of what the Fabian socialist William Pember Reeves called the "state experiment" in New Zealand was ultimately much more complete economic stagnation than in Australia, culminating in the economic crisis of 1984. David Lange, the incoming prime minister in the election of that year, likened New Zealand to a Polish shipyard.

Of course, it was not as if New Zealand's predicament only became apparent when we found ourselves peering over the cliff a decade or so ago. In the early 1960s, official reports were already calling attention to the fact that New Zealand had the poorest productivity growth among the industrial countries. Robert Muldoon was elected prime minister in 1975 on the basis of his reputation as a finance minister capable of putting things right. The problem is that putting right things like high inflation and budget deficits always involves up-front costs, and Muldoon repeatedly backed down when the going got tough. His three wasted terms were characterised by tinkering, stop-go policies, increasing state ownership of industry, a steady slide into higher debt and bigger economic distortions.

A point worth emphasising, however, is that Muldoon did not deliberately set about to sabotage the economy. In many ways, as with the CER agreement, he was trying to do the right thing. But he was reacting too slowly in the face of growing problems. His approach was described as "timid gradualism." New Zealand kept losing ground relative to countries that were adjusting faster, and the problems got worse. If there is one lesson New Zealanders should retain from the Muldoon era, it is the perils of timid gradualism.

By the early 1980s, some Australian government officials were beginning to wonder whether Australia would end up having to bail New Zealand out of bankruptcy. That assessment is hard to quarrel with. Subsequent Australian interpretations of New Zealand events have been rather more variable. New Zealand does not loom large on Australian radar screens. In Paul Kelly's nearly 700-page book on Australian politics in the 1980s, it is mentioned twice. Some commentators like Alan Wood, Paddy McGuinness and John Stone have called the shots on New Zealand very accurately. Others have been well off target.

One line of commentary through the 1980s interpreted New Zealand as doing much the same things as Australia, but faster - a hare and a tortoise comparison. Another saw it as a "monetarist experiment." Critics pointed to the contrast between employment losses in New Zealand and employment gains in Australia, and to the long recession in New Zealand from 1988 to 1991. In the eyes of some commentators, the goods and services tax seemed to be the linchpin of our reforms. The labour reforms of 1991 were portrayed by the ABC as a descent into barbarism. The reaction of the *Australian Financial Review* to the 1993 general election and referendum results was "Kiwi Voters Drop their Bundle." Its reaction to the recent budget was "Kiwi Magic Leaves us Spellbound."

Recently your federal Treasurer called our restructuring policies "crude" and "brutal." No one seemed to get very upset. From our experience in watching Dame Edna slag off her Kiwi offsider, we knew it was said in a caring and sharing sort of way.

There's an element of half-truth in some of these observations, but the overall picture is somewhat out of focus. My own snapshot would be along the following lines:

- New Zealand started its economic reforms in a far worse position than Australia;
- some features such as financial market liberalisation, currency deregulation and tariff reform were common to the two countries, but New Zealand's programme was more principled and hence more comprehensive;
- New Zealand emphasised the medium-term fundamentals of macro stability and micro flexibility, whereas there has been a stronger emphasis on Keynesian-style demand management and a collectivist incomes policy framework in Australia;
- the necessary deep restructuring naturally meant that New Zealand initially lost ground relative to Australia, although the economy continued to grow in the 1984-88 period when confidence in the programme was high;
- the New Zealand Labour government's strategy became progressively less coherent as labour and welfare reforms were left in the 'too hard' basket and government spending continued to grow. Coupled with a tight monetary policy, this put unwarranted pressure on the real exchange rate and the internationally exposed sector of the economy;
- the 1987 sharemarket crash and the disintegration of the Lange government in 1988 led to a collapse of confidence, a deterioration in the fiscal position, battered company balance sheets, recession and higher unemployment;
- a second wave of reforms was initiated by the National government which came to office in late 1990. The key measures were the freeing up of the labour market, tighter fiscal discipline and some welfare reforms; and

- the more complete and consistent policy framework took pressure off financial markets and the currency, and improved our international competitiveness. This generated an export-led recovery which is now into its fourth year, a far longer and stronger period of expansion than any upturn in the last thirty years.

Inevitably the reforms came at some expense, but most of the pain was due not to the speed or depth of the restructuring but to the legacies of the earlier policy failures. There were already economic casualties before 1984 and there would have been many more if New Zealand had continued with timid gradualism. Looking back, a clear lesson from New Zealand's experience is what not to do: attempt an uneven pace and spread of reform. Eastern European experience has confirmed that economies which go for fast, radical and comprehensive reform achieve the most successful transition, the Czech Republic being the outstanding case.

Mr Willis would therefore have had a point if he was criticising New Zealand's unduly protracted transition, in particular the "teabreak" that David Lange called on the reforms in 1988. He would also have been correct in speaking about an unnecessarily brutal programme if he was thinking about the Labour government's failure to free up the labour market. This should have happened early in the programme and, if it had, many tens of thousands of workers would not have ended up on the unemployment register. But I am not sure that these are the kind of criticisms the Treasurer had in mind. (I did notice, however, that Bob Gottliebsen commented in a recent Business Review Weekly editorial that "in Australia we are showing our continued callous disregard of the unemployed by going the other way and talking about increasing minimum wages.")

I should immediately add that many of the criticisms in New Zealand of the reforms were at least as wide of the mark as those offshore. We were told that they were a mad experiment, despite being orthodox economics and in line with what many other countries were undertaking. We were told that eliminating inflation was inconsistent with growth, despite all the evidence that inflation is harmful to the efficient operation of the economy and investor confidence. A group of academics told us that the fiscal correction in 1991 would worsen the recession, whereas it marked the turning point of the recovery. Then the recovery was going to be a "jobless" one, whereas it has been churning out jobs at a furious pace.

Lately the complaint has been that the benefits of recovery have not been fairly spread, with low income groups in particular missing out. This too is almost

certainly wrong. A recent EPAC study of income distribution in Australia reports evidence in the 1990s of real incomes from employment growing across the entire income distribution, in contrast to real income falls in the 1980s. I suspect the same thing is happening in New Zealand. The freer markets for labour have spread employment opportunities around in a much more socially just way than collective systems, which benefit those in jobs with high wage increases but exclude outsiders from work. Long-term unemployment, Maori unemployment and youth unemployment have all fallen sharply.

Despite the massive restructuring, the New Zealand economy recorded average annual real growth in the ten years 1984-94 of 1.6 percent, a slight increase on the 1.4 percent rate in 1974-84 - a period that some New Zealanders still regard as the "good old days." More importantly, recent performance and the current outlook are exceptionally good:

- growth has averaged over 5 percent in each of the last two years, and the budget forecasts suggest that, over the six years to March 1998, the economy will grow by an average of 4.2 percent;
- inflation has averaged 1.6 percent over the past 4 years;
- employment has grown by nearly 10 percent to record levels since the labour market reforms, and overall unemployment has come down from nearly 11 percent to 6.6 percent of the labour force;
- the current account deficit has been stable at around 2 percent of GDP despite high investment, and is expected to fall. National savings are rising sharply and export growth is matching the growth of imports;
- the budget surplus is expected to be 3.6 percent of GDP this year and to rise to 7.7 percent of GDP in 1997/98 in the absence of tax cuts; and
- net public debt is expected to be 34 percent of GDP in 1995/96, down from 51 percent in 1991/92, and is continuing to fall fast.

At long last New Zealand is starting to make up ground on Australia. The New Zealand dollar has appreciated some 40 percent against the Australian dollar since the mid-1980s. Our long-term bond rates have been 1-2 percentage points below yours. New Zealand has moved rapidly ahead of Australia in the rankings in the

World Competitiveness Report. We are becoming a much better market for your exports, which grew by 40 percent over the last two years, putting New Zealand only just behind the United States as Australia's fourth largest export market. We are keen to attract a similar increase in investment by your major institutions.

There are still some in New Zealand who look at the present situation as just a passing spell of sunny economic weather, even though it may be lasting more than 5 minutes. They don't link the new economy with the hard work under the Roger Douglas and Ruth Richardson reforms. The reality is that the economy is now operating in a fundamentally different framework. Key pillars of this framework are:

- the progress towards a fully open, competitive economy. New Zealand tariffs are scheduled to be slightly lower than Australia's by 2000 and to go to zero thereafter;
- the Reserve Bank Act, which commits the central bank to the single target of price stability;
- the Fiscal Responsibility Act, which lays down criteria for sound fiscal management and requires the government to nominate its goals and report progress towards them in a transparent way. The Crown's accounts are also now prepared like any other business on an accruals and GAAP basis, with clear statements of public assets and liabilities;
- the Employment Contracts Act, which has moved the legal-institutional framework of the labour market on to a contracting basis, similar to general contract law. The basis of contracting is now between the firm and the employee. Collective bargaining is permitted and facilitated but bargaining agents like unions and employer groups are no longer given statutory protection. Strikes are not permitted while a contract is in force, only after it has expired.

In addition, most product markets have been deregulated; government commercial activities have been corporatised and many of them privatised; a broad-based, low rate tax strategy has been implemented (including the GST); and there have been significant changes to education, health, housing and superannuation policies. All these moves have strengthened the economy - there is nothing random about the sunny weather and no unexplained economic miracle.

Despite all this, I believe both New Zealand and Australia remain well off the pace in achieving a set of economic and social policies which would maximise our opportunities and living standards. Even by comparison with Australia, New Zealand still has a lot to be modest about. You were not foolish enough to adopt our state monopoly accident compensation scheme; you have made more progress than we have in dismantling statutory agricultural marketing arrangements; you are ahead of us on restructuring and privatisation in electricity and water; your welfare system is more targeted and better administered than ours; and on the criterion of how well the education system meets the needs of a competitive economy, Australia is in 9th place in the IMD survey whereas New Zealand is in 17th place, one above India.

But neither country is the relevant benchmark for the other. The relevant benchmarks are the high productivity, high income, high employment economies, particularly those in East Asia which, unlike us, have never had to throw off collectivist legacies and are continuing to surge ahead.

The success of the East Asian countries is primarily due to the same set of fundamental, market-oriented policies that New Zealand and Australia have been endeavouring to implement, but in many respects the quality of our policies still doesn't measure up to theirs. They have pursued outward-looking policies for longer than we have, and Hong Kong and Singapore have been free trade economies for many years. Their levels of government spending, taxation and debt are well below ours. To all intents and purposes they are fully employed economies, due to their more flexible labour markets. State-owned enterprises account for a much lower proportion of economic activity. Asian education is noted for its high quality, especially in vocationally and technologically sophisticated disciplines. Their welfare systems work whereas ours have failed us, and they constitute a big competitive handicap. It is little wonder that even at the peak of a cycle our economies only match Asian growth rates in a slow year.

The benefits in today's global economy of an enterprise-friendly fiscal and regulatory environment of the kind the East Asians have created were vividly demonstrated by the Queensland government's recent decision to halve stamp duties. The New South Wales and Victorian governments were quickly forced to follow suit, although hardly with good grace. Some press reaction was decidedly hostile. I was amused at a commentary by a lead writer of the *Canberra Times* which described Queensland's

action as: "another poisonous apple in the fools' paradise of competitive federalism ..." and went on to say:

Competitive federalism ... is a flawed view. Sometimes the best conditions for business result in poor living standards. ... Low taxes are helpful up to a point, but after a time they result in poorer services and poorer infrastructure to the very businesses you are trying to attract."

I suppose this type of nonsense could only have been written from Canberra - although it reminds me of the fear-mongering and dire predictions by many media organisations in New Zealand during almost every reform initiative of the past decade. Of course, competitive federalism should take the form of creating a generally attractive location, not bribing specific firms with tax breaks or subsidies. I also saw a complaint by an Australian union secretary who said the move would unduly constrain Queensland's already low level of social spending. The fact that it created jobs in Queensland seemed to be irrelevant. Attitudes like these indicate that some members of what former Finance Minister Peter Walsh would call the chattering classes still have a vast amount to learn about the realities of global competition. Fortunately, they do not seem to be dissuading the thousand or so Australians who each week are voting with their feet and moving to Queensland, apparently unconcerned by Queensland's inadequate social spending.

For my part, I applaud the Australian Stock Exchange's campaign on stamp duties. New Zealand totally eliminated stamp duties on share transactions seven years ago. Both our countries must stop piling on the tax burdens and regulations that are stifling corporate governance and making our capital markets less efficient. I wish the ASX could help its New Zealand counterpart and others opposing ill-considered moves in New Zealand to impose new regulations on takeovers, regrettably along Australian lines. In the panic that followed the 1987 sharemarket crash, our regulators said such regulations were necessary to restore foreign investor confidence in our equity markets. Though nothing was done, foreign investment has flooded in, to the point that other groups are now complaining about the extent of offshore holding of New Zealand equities. Yet still our regulators and minister of justice are persisting with proposals that have no justification on either efficiency or equity grounds. Even more bizarre, the New Zealand Business Roundtable, an organisation of chief executives who might be expected to lobby for regulations on takeovers, is accused of being a vested interest for opposing them.

It's easy for New Zealanders to feel flattered when leading Australian business people like Don Mercer of the ANZ comment that:

Most of us in business in Australia look with absolute envy at what New Zealand has achieved.

Some New Zealand journalists, too, have taken to writing things about Australia like:

With its growth rate still lagging behind this country's, unemployment bouncing back to 8.5 percent, a deficit the size of several woolly mammoths, a labour market in rigor mortis, and its currency rapidly falling close to parity with the Kiwi dollar, Australians are looking in a somewhat startled fashion at New Zealand's performance.

But there's no case for New Zealand indulging in self-satisfaction. Our economy is very vulnerable to policy and political risk. There is still a risk premium in our interest rates of around 1 - 1.5 percent, and we are far away from regaining the triple A credit rating we enjoyed until 1983. The government has a target of 3.5 - 5 percent annual growth to the year 2010, but without further significant reforms I very much doubt that it will be achieved.

The fact that Australia is struggling with the challenges of reform is also bad news for New Zealand. The airline fiasco has given a whole new meaning to the term 'microeconomic reform'. The use of taxpayers' money to fix industrial problems, as in the shipping industry, or budgets with company tax increases, random new sales taxes and creative accounting, take us back to the Muldoonist chamber of horrors. By the time Australia gets around to completing vital tasks like labour market reform and telecommunications deregulation and privatisation it will be lagging at least ten years behind New Zealand. An Australia that is performing so far below its vast potential does nothing for us. We are sorely missing a strong stimulus from Australia to keep up the momentum of our own reforms.

The sorry story of the opportunities we are missing was summed up recently by one of New Zealand's more hard-headed economic commentators, Gareth Morgan, in the following terms:

All around New Zealand is strewn evidence of half-completed economic reforms, the net impact of which is invariably significant costs to economic efficiency, and a lower standard of living for those affected. The policy paralysis which has steadily descended since 1991 may well be seen as either a consequence of the democratic process of transition from FPP to MMP, or as

just the inevitable outcome of a conservative political regime which is uncomfortable with change. Whatever, its economic cost is unambiguous.

We seem to have forgotten the warning about 'reform fatigue' that Lee Kuan Yew delivered in Australia last year. He pointed out that more reform was unavoidable, or the ordeal already endured might be wasted. The same lessons are coming from other countries. In Argentina, the re-elected government of Carlos Menem is pressing on with deregulation, privatisation and labour market reform, and its economy is likely to exceed Australia's in size in the near future. A comment by an Indian businessman in the *Australian Financial Review* last year summed up a dilemma which is easy for a New Zealander to relate to:

It's a question of whether [India's] economy will grow at 6 percent a year if there are no further reforms, or 10 percent a year if we really move ahead with reforms. ... Instead of blowing its trumpet, the government is being apologetic. They've not done a good job of taking the people into their confidence, of telling them what reform is doing for the country. Some politicians still seem to think that good, strong, economic policies are somehow immoral.

The irony is that with sustained growth and falling unemployment, the challenges to adjust that lie ahead would be far less formidable than those of the last ten years. From next year, New Zealand can look forward to large tax reductions over several years, provided government spending is tightly controlled. In any case much of the talk of 'pain' is misplaced - where's the pain in governments spending less of taxpayers' money?

Nevertheless, those who have a vision of what both our countries might become will have to continue to work hard to overcome the impoverishing legacy of our collectivist past. In significant sections of the community and some political parties there is still a hatred of the profit motive, a wariness of commercial competition, class anger, an instinctive belief that business is best organised by the state, and an urge to 'correct' markets by taking and redistributing money. Every day on the airwaves, talkback hosts on six-figure salaries instruct their audiences about what they call the savage inequalities of capitalism.

Far more important than who the next government will be in Australia, or what the new electoral system will mean in New Zealand, are the vision and ideas that will hold sway. Will the electorate and our political parties jettison outdated ideological baggage as the social democrats did in post-war Germany and the British Labour Party appears to be doing today?

The answer to that question will in part depend on the role the business sector decides to play in both our countries. Hugh Morgan in a speech a few years ago pointed out that:

Corporations are important as social institutions as well as economic agents. If the corporation can articulate and uphold its legitimacy, it can provide ... a shield against attacks on our traditional liberties.

Marx knew that to achieve his goals the business classes had to be destroyed. Newt Gingrich recently made the point that "American businesses can't win in the marketplace for products and services if they concede defeat in the war of ideas." Too often in the past, people in business have just gone along with policies that they knew were bad for the economy and bad for their firms in the long run. They must do more to explain the merits of competition and the enterprise system.

Through all of the reform debate over the past decade, the New Zealand Business Roundtable has scrupulously maintained a long-term, national interest focus, and backed its policy prescriptions with detailed, rigorous research. For this, we earned the hostility of elements of the media, trade unions and other commentators. Sometimes we were tempted to offer them Adlai Stevensons's bargain: If they will stop telling falsehoods about us, we'll stop telling the truth about them. But our response was merely to plough on and keep focused on the ball and not the players.

Both the Labour and National governments that have been in office have given our ideas careful consideration, not always agreeing with them but willing to discuss issues on their merits. Political partisanship one way or another has not been in question. This, I believe, has been a key to any effectiveness we may have had. An important factor has been a willingness to persist fearlessly with arguments despite knee-jerk and dismissive reactions to them. Such reactions were particularly a feature of the Muldoon era in New Zealand and seem to plague Australian political life far too often today.

My observations on the economic policy debate in Australia would suggest a good deal of frustration among business that its views are often not being listened to, far less heeded. It's tempting in this situation to abandon, or at least temper, the policy prescription and instead seek greater involvement in decision-making processes - the so-called politics of inclusion. This may make sense if there is something wrong with the message, but not otherwise. Changing tack and seeking to be loved will only

leave business representatives in the position of the miserable creature Ronald Reagan described as the fellow who hoped the crocodile would eat him last.

It would be better to re-examine how the views of the business sector are being prepared and marketed. Is the background research of unimpeachable quality and consistency? Are the results being debated and accepted within the appropriate professional circles? Have adequate efforts been made to communicate and explain them to the media and the public?

On the basis of New Zealand's experience, there is no reason for pessimism about the prospect of even quite radical ideas being taken up and finding their way into policy. What is politically impossible today often becomes conventional wisdom tomorrow. Business must be in for the long haul.

The tide of ideas is still running strongly in the directions which began to influence policy in the 1980s. For the first time this century, collective governmental action is not seen as the solution to most problems; rather it is often seen as their cause. Many societies are now engaged in the enterprise of evolving a new liberal vision of what governments should do and what institutions should govern the interactions of citizens in a free society.

This is not an anti-government vision: it is one that affirms a governmental role as rule-setter, supplier of public goods and guarantor of a basic safety net. However, it seeks to limit government to those functions that only governments can undertake, and to insist that they are performed well. There is a disillusionment today with governments because they have tried to do too many things, and ended up doing them badly. The vision is not a purely material one either: it is one that reaffirms the basic goals of freedom, security, justice, equity, and a good environment, as well as economic welfare.

The evolution of a coherent vision will present many challenges and take many years to implement. Businesses are the wealth-creating institutions of our societies. If businesses and business organisations are not prepared to present and defend a vision of how we can better achieve prosperity and security, who will? I hope you will take up those challenges and contribute to the reform agenda that both our countries need. In an ever-changing world it is a task that has no end.