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**EMPLOYERS AND MANUFACTURERS ASSOCIATION
BUSINESS ENVIRONMENT 2000:
'THE VISION'**

**A POSITIVE AGENDA FOR THE
BUSINESS SECTOR**

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A POSITIVE AGENDA FOR THE BUSINESS SECTOR

It is a commonplace nowadays for businesses in New Zealand to be benchmarking themselves against leading firms in their industries in other parts of the world. We have to aspire to international best practice if we want continuous improvements in living standards. Many New Zealand businesses are operating in an increasingly open world economy and they must match the cost savings and innovations of their competitors if they are to survive.

Similarly, New Zealand must benchmark its economic policy environment against that of leading nations. A remote country with inherent natural disadvantages must do everything in its power to offset them by adopting policies that are attractive to internationally mobile capital, people and businesses.

One of the penalties of distance is that the public is not always fully aware of developments in the rest of the world. This was a serious problem in the decades when New Zealand became an increasingly inward-looking economy. It took interventionist policies to a level not found in any other advanced country, and suffered a drastic decline in relative living standards. There is much more involvement now with the outside world, especially by younger people, but the country is often still slow to recognise and adopt important ideas and trends.

It is true that over the past 15 years we have learned some of the lessons of international economic success. The minister of finance, Dr Cullen, recently acknowledged in a *Herald* article that the moves to free up the economy were not "an experiment", as many have claimed. Economic liberalisation is in fact a mainstream development common to all OECD countries without exception, and many others as well. In a study for the Business Roundtable, David Henderson, a former senior OECD official, pointed out that, contrary to a widely held view, liberalisation does not represent a victory for conservative or right-wing ideas and principles. Historically and in the modern era, economic liberalism rather than interventionism has been espoused by parties of the left and right alike, in the interests of creating an entrepreneurial and dynamic business

climate. Thus there is no reason in principle why a centre-left government should be negative for business.

To date, however, the thrust of the coalition government's policies is running counter to international trends. I can't think of any other country with a programme which includes moves to raise the marginal tax rate, renationalise accident insurance, halt privatisation, reduce competition in health and education and re-regulate the labour market. The deputy prime minister, Mr Anderton, has declared that "the free market policies of the last century failed". Most politicians around the world would say that the major sources of failure last century were socialism and big government. It is clear that we have some way to go to establish a consensus on what constitutes sound policies.

So I thought it would be useful to reflect on what has happened and is still going on around the world, and on the international lessons of success. Often we hear it said that "the pendulum has swung too far" in this country. But it is hard to see where New Zealand is out on a limb today in relation to other countries, and I see few signs that other countries are changing their basic directions, regardless of the political parties in office.

My reason for taking this approach is that it is not good enough for the business community to simply criticise government decisions that it thinks are mistaken. It should also be promoting a positive agenda for New Zealand. Many of us in business felt that New Zealand governments lost their way during the last two parliamentary terms, and that our economic performance has suffered as a result. We have no interest in defending the results of recent mismanagement. Rather, the concern of the business sector should be to highlight the costs of recent policy drift, to alert the public to further policy mistakes and to promote policies for better performance, drawing on international experience.

In looking at developments around the world, I do not wish to suggest that policies adopted by other countries necessarily make sense for New Zealand. The laws of

economics are pretty general, but there are always local factors that need to be taken into account. Moreover, there are no perfect models; no country has solved all its problems. Indeed there are plenty of examples of bad policies around the world, even in relatively successful countries. It would make no sense for New Zealand to engage in agricultural subsidies just because the European Union and other countries do. The same argument applies to interventionist industry policies which many countries engage in. Policies should be framed in the first instance on the basis of sound economics. But it is always useful to look for evidence internationally as to what works and what doesn't, and to observe the directions that successful countries are following as they respond to changes in economic thinking and practical experience.

There is no doubt that the economic landscape has changed remarkably in the past 20 years. In the 1970s Keynesian economics was the influence behind monetary and fiscal fine-tuning in many countries. Incomes policies were commonplace. Many industries were heavily regulated. Welfare states were expanding. Both the government sector's share of national income and tax rates were on the increase. There was extensive nationalisation of industries.

In response to the inflation and slow growth of the 1970s, there has been a turnaround in economic thinking and practice. Twenty years later it is hard to remember some of the debates and reactions as governments sought to change direction. Today, the consensus in favour of stable macroeconomic policies, open markets and smaller government is continuing to strengthen.

Consider first the United States. It is entering the twenty-first century unchallenged in terms of technological innovation, job creation, and success in reversing welfare dependency, crime and other social indicators. In the Reagan years, however, there was much talk of policies leading to de-industrialisation, a 'hamburger-flipping economy', 'short-termism' on the part of capital markets, and an obsession with 'the quarterly dividend'. Many critics saw the United States losing its industrial supremacy to Japan and advocated Japanese-style 'industrial policies'. As late as 1992, economist J K Galbraith stated that:

[US] competitive strengths are no longer great enough to support our living standards at full employment.

Today those voices are largely silent. The United States is operating at close to full employment and the painful economic restructuring and wage stagnation of the 1980s have been succeeded by rising living standards for all groups, including the poorest. In the five years to 1998, real incomes for the lowest 20 percent of families rose at an average rate of 2.7 percent a year, according to the Council of Economic Advisers.

To all intents and purposes, the Clinton administration took over where previous Republican administrations left off. President Clinton shifted the Democratic Party in a pro-business, pro-free trade direction. He went beyond Reagan in tackling welfare reform. He embraced the notion of a balanced budget. During Mr Clinton's administrations federal spending has fallen as a percentage of the US economy from 22 percent to 18.3 percent. Total government spending in the United States has fallen by a similar amount – to 32.3 percent in 1999 compared with 41.5 percent in New Zealand, according to the OECD.

Much the same thing has happened in Britain. In opposition, Tony Blair confronted the backward-looking elements in the Labour Party, and in office he has essentially maintained the thrust of previous Conservative government policies. Only minor changes were made to the Thatcher government's labour reforms, and Mr Blair has done things like making the central bank independent and introducing tertiary fees which Mrs Thatcher would not have contemplated. The government is now planning to privatise the commercial arm of the BBC. The payoff from 20 years of reforms is one of the strongest economies in Europe. A threat for the future might be an upward creep in government spending under Labour, after a disciplined start.

In continental Europe, where problems of unemployment and welfare dependency have remained more entrenched, attitudes towards Anglo-Saxon capitalism appear to be changing. As *The Economist* wrote in a leader in February:

To a surprising extent, especially when measured against what

politicians say, Western Europe's parties of the left, many of them now in power, are moving away from their traditional statist dogmatism towards a pragmatic, if reluctant, recognition of unavoidable economic facts ... People are voting for lower taxes, less public spending, a lighter hand of regulation: that is why hitherto leftist governments have made a start on delivering them.

Besides Britain, the Netherlands, Denmark and Ireland have moved away from European-style, heavily regulated labour markets and are reaping the rewards with increased job creation and investment. All European governments, including even France under a socialist government, are continuing with privatisation programmes. Company tax rates are falling. There is a move from fuzzy notions of stakeholder capitalism to a focus on shareholder interests, most dramatically illustrated by the recent Vodaphone-Mannesmann takeover. "Germany as a closed system ... is over", its finance minister told the recent Davos economic summit.

Closer to home, the strong performance of the Australian economy is routinely attributed to 15 years of steady economic reform. We are often told that Australia has done things differently from New Zealand. The balance sheet of changes in Australia now includes financial market deregulation and the floating of the exchange rate; a reduction in effective manufacturing protection from around 35 percent to around 5 percent; an independent monetary policy targeted at low inflation; sustained fiscal surpluses and a lower ratio of government spending to gross domestic product (GDP); reforms in utility industries including corporatisation and privatisation; deregulation of telecommunications, electricity and agricultural marketing; labour market deregulation; public sector reform; the introduction now of a goods and services tax and a planned lowering of the company tax rate to 30 percent. Does this sound like a different programme from New Zealand's? I don't think so.

It is sobering to reflect on how commentators in Australia are now viewing New Zealand. The deputy editor of the *Australian Financial Review* wrote in a recent article:

[New Zealand] is no longer a leader ... the centre of industrial and financial reform as it was throughout much of the 1980s. Reform is not even on the agenda ... For Australian investors, the most likely

source of concern for Australian corporates who do business in New Zealand are Labour's plans to restore unions to the central role in collective bargaining.

Australian governments at both federal and state levels are generally trying to make more progress with privatisation and with reforms to labour markets, tariffs, education, health and welfare. In some cases they are struggling, and there have been some populist reactions and backsliding. But the overwhelming message from business in Australia is: "don't stop the reform process now".

Finally, in Asia the picture is of a rapid rebound from the 1997-98 crisis as governments stuck with open market policies, addressed problems in banking systems and corporate governance, and backed off some of the interventionist industry policies that contributed to their undoing. From China to India, there is a steady, continuing push towards economic liberalisation, and the same is true of several countries in Latin America and in South Africa. A question mark still hangs over Japan, where the huge growth in government expenditure, taxation and debt over the past 30 years and heavy regulation of many sectors are holding the economy back.

All in all, this is a picture that seems to have clear implications for New Zealand or any other country that wants to succeed in the modern world. The message is reinforced for New Zealand by the OECD, by no means a radical organisation but one that broadly reflects the consensus views of its member governments. In its recent reports on New Zealand the OECD has stressed the need to pursue an ongoing reform programme, not the "stop-and-go reform effort" of recent years. It has criticised the blow-out in government spending, urged a resumption of the "largely stalled" programme of privatisation, argued for bulk funding of schools and more competition in health and education, recommended changes to personal grievances provisions and the Employment Court, and proposed limitations to superannuation and welfare benefits. All these recommendations are in line with actions being taken elsewhere but run counter to current directions in New Zealand. There is no talk in OECD circles of a case for more 'hands-on' policies.

Against this background it is hard to see the basis for Mr Anderton's claims that liberal economic policies have failed. One of the most clear-cut conclusions of economic research in the past 20 years is the positive relationship between economic freedom and growth. As *The Economist* summarised it recently:

The conclusion is abundantly clear: the freer the economy, the higher the growth and the richer the people. Countries that have maintained a fairly free economy for many years did especially well.

Governments have an important role to play in setting a clear and predictable macroeconomic and regulatory climate, protecting property rights, enforcing the law, avoiding inflation, underwriting access to health and education and providing a social safety net. Beyond that, however, they should make maximum room for individual initiative and business enterprise.

I believe that the business community must keep the liberal reform agenda before the public. There is no evidence that the course which the government is embarking on will make New Zealand more prosperous or create a fairer society. The business community, the media and opposition parties need to press the government to justify its actions by reference to accepted economic thinking and evidence of success elsewhere. There is no need for this to be a confrontational process, but it is perfectly reasonable to expect explanations and evidence.

It is not, for example, sufficient for the government merely to claim that it has an election mandate to implement particular policies. Sir Robert Muldoon could make the same claim, but his policies nearly bankrupted the country. Surveys and submissions on the ACC legislation indicated that there was majority opposition to the changes. There is no obvious majority in support of repealing the Employment Contracts Act 1991. Governments in office have far more information than parties in opposition and have a duty to listen to advice and reconsider unwise plans. The belief that majorities are always right has led to disastrous policies, and to a disregard of the views and rights of minorities that has no place in a democracy.

The government has said it wants a dialogue with the business community, but a constructive dialogue must involve a willingness to take on board business concerns. Many in business are finding it difficult to understand how the policies the government is actually following will help achieve its targets for economic growth and employment. Overseas observers are struggling to make sense of New Zealand's directions. To the prime minister's claim that there is "no relationship" between tax rates and growth, a *Wall Street Journal Europe* editorial response was, "Where has she been looking?" Major international investors have quietly been reducing their exposure to New Zealand. Its policy environment is not compensating for the natural difficulties of doing business in a small, remote economy.

Business leaders who are concerned about New Zealand's future must therefore tell it as they see it. If they believe current moves will produce bad outcomes, there is no point being wise after the event. They can take confidence from the lessons of successful policies elsewhere, and from the benefits that economic reforms were delivering in New Zealand in the early 1990s before a consistent policy framework was allowed to unravel. Whether or not politicians heed such messages in the short term, the business sector must keep in front of the public a positive agenda for New Zealand.