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**NEW ZEALAND SOCIETY OF CORPORATE TREASURERS**

**CAN WE AFFORD TO REPLAY THE ECONOMIC  
PAST?**

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## **CAN WE AFFORD TO REPLAY THE ECONOMIC PAST?**

Businesses up and down the country will have started the new year reflecting on the new millennium, the implications of the change of government, and the forces that are shaping the international environment in which New Zealand firms are increasingly operating.

The world economy looks to be set for a good year. The US economy is continuing to grow strongly, Europe is in better shape, and many Asian countries have bounced back from the traumas of 1998. The improvements of recent years have been driven by the efforts of many governments over the past two decades to free up their economies, the more stable environment for investment created by central banks, and the wave of technological innovations that are transforming business processes worldwide.

By and large the 1990s were a better decade in terms of economic performance than the previous two, and the next 10 years could be better again. The economic environment in parts of the world, led by the United States, is starting to look more like that of the 1950s and '60s with low inflation, higher rates of productivity growth and improvements in many social indicators. In the next 10 years unemployment rates could come down a lot further, particularly if more governments free up their labour markets and reform welfare systems.

The short-term outlook for the New Zealand economy is also favourable. Our export industries, including agriculture, are now generally enjoying the benefits of a lower exchange rate and stronger demand in world markets. The cyclical upturn could well deliver annual growth of 3 percent or more over the next year or two.

But we should not allow the cyclical improvement to mask a number of underlying risks and concerns. Three, in particular, stand out.

First, there are always surprises in economic life, often nasty ones. We have not seen the last of such things as droughts, falls in world sharemarkets and regional economic crises. The previous government was far too complacent about New Zealand's economic position and was caught offguard by the Asian downturn.

Secondly, New Zealand's economic framework has become a lot weaker since the early 1990s, and economic performance has suffered accordingly. Large increases in government spending which have crowded out private spending and pre-empted tax cuts, the slowdown in asset sales and the debilitating growth of regulations have all taken their toll on the private sector, and international competitiveness has been eroded. Whereas New Zealand had a low balance of payments deficit and falling external debt by the mid-1990s despite strong economic growth, it has since had a large external deficit despite much weaker economic growth.

In addition, since the early 1990s successive governments failed to maintain efforts to make the economy more competitive and robust, as well as deal with outstanding problems in areas such as health, education and welfare. Many commentators were sounding warning bells but they were ignored. For example, a 1997 editorial in the *Australian Financial Review* observed that:

Unfortunately, reform has slowed sharply in the past three years. [Ruth] Richardson's departure in 1994 marked a turning point. Little has been done since, apart from the passage of the Fiscal Responsibility Act and some tax cuts. And now a system of proportional representation ... is hindering leadership and allowing fringe players ... to stymie further reform.

While New Zealand was sitting on its hands, many other countries pressed on with reform programmes. Australia, for example, has now done practically everything New Zealand has done over the past 15 years and more. In particular, it has achieved a much sounder fiscal position than New Zealand. The Howard government's action to cut public expenditure and restore budget surpluses, at a time when the National/New Zealand First coalition government was boosting an already high rate of growth of government spending, put Australia in a much better position to weather the Asian

economic storm. Although Australia is in many ways grossly over-governed, spending at all levels of government in Australia is set to fall to 32.5 percent of gross domestic product (GDP) this year, according to the OECD. This is well below New Zealand's projected level of nearly 40 percent which is above the OECD average. The overall tax burden in Australia is correspondingly lower, as is Australia's public debt.

The third concern that I believe many in business in New Zealand will share is with some of the new coalition government's stated policy intentions. The overall thrust of recent National-led governments could hardly be described as business-friendly, and the Labour-led government has a chance to adopt a more positive pro-business stance. Tony Blair openly describes New Labour in Britain as "the party of business", and the Clinton administration has been strongly business-oriented. But in contrast, New Zealand's new ministers have been saying business is not going to like some of their plans, and I fear they are right. This does not augur well for the business environment, and hence for wealth and job creation.

Certainly, some of the government's early moves have not been encouraging. Contrary to the British Labour Party's themes of 'modernisation', they seem more like a replay of our economic past.

First off was a return to a more graduated tax scale with the increase in the top personal rate to 39 percent. This starkly contradicted the government's professed desire to attract and retain the talented professional and entrepreneurial people that New Zealand desperately needs. Firms will face higher costs as they are forced to adjust remuneration packages to retain such staff, and shortly we shall no doubt hear more complaints about growing pay inequalities. New Zealand learned for a time the many benefits of a flatter tax scale, and the move takes us back to the bad old days of widespread tax planning. The government will soon introduce a new range of tax avoidance measures that will add to compliance costs for businesses and other taxpayers.

Parliament now has in front of it the legislation restoring the state monopoly in accident compensation. If ever a social experiment was tested to destruction, it was surely New

Zealand's ACC scheme. It was an abysmal failure, and within a few short months the benefits of introducing competition in accident insurance were seen to be as dramatic as they were with telecommunications, taxis, airlines, rail transport, postal services and other industries. If the monopoly is restored, nothing is surer than that the ACC will sooner or later drift back to its unresponsive and inefficient ways and the benefits of choice will be lost. This proposal is a total no-brainer. There must be an all-out effort by business and others to persuade parliament to abandon it.

Next up will be proposals to turn back the clock on the Employment Contracts Act. The ECA was compromised at the outset by the foolish decisions to greatly extend the scope of the personal grievance industry and retain an activist Employment Court. The subsequent ministerial inertia by National was shameful. As a result, the country has lost thousands of job opportunities and all enterprises, including schools, hospitals and government agencies, face large risks and costs in dealing with under-performing staff. The Employment Court's shadow looms large over many of the so-called 'golden handshakes' in both the public and private sectors that have rightly caused public outrage. Far from remedying these flaws, however, the government proposes a return to union-driven collective contracts on the basis of 'good faith' bargaining. This will mean a field day for union officials and lawyers, but workers, employers and particularly the unemployed will pay the price.

Other back-to-the-past moves are the proposals to freeze or increase tariffs, and to reintroduce industry subsidies. To their credit, most in the business sector in New Zealand came to accept the folly of Fortress New Zealand policies and were weaned off corporate welfare. There may always be foolish protectionist moves by other countries such as the recent US decisions on lamb, but it makes no sense for New Zealand to copy them. Tariffs raise domestic costs and thus tax export industries, and industry subsidies favour some firms or activities at the expense of others and mean higher taxes all round. I hope most in the business community continue to support moves to full free trade, to say 'thanks but no thanks' to offers of subsidies, and to argue for lower taxes instead. A few, however, still seem to want to make businesses wards of the state.

Further down the track, business is threatened with new takeover regulations, restrictions on mergers, and moves away from light-handed regulation of network industries. In the social field there are

plans to go back to elected health authorities, abandon bulk funding of schools, boost subsidies to tertiary education, and increase superannuation, housing subsidies, welfare benefits and minimum wages. Many of these are very costly and are certain to accentuate welfare dependency.

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. We moved away from tariffs and subsidies because they only propped up uncompetitive industries and we scrapped area health boards because they were a recipe for parochialism and inefficiency. We learned to our cost that interventions beget more interventions and micro-management, and that there needs to be a clear-eyed view about the proper limits of government and what governments can and cannot achieve. It seems futile to hope that a return to past policies will produce different results today. New Zealand was not a successful, happy, fair and cohesive society under its previous policies and a return to them does not seem to me to offer a solution to our present problems.

More generally, a coherent picture of the government's overall approach to economic management is not emerging. As finance minister, Dr Cullen reacted to the last GDP figures by suggesting the economy was becoming overstretched, yet he attacked the recent Reserve Bank move to nudge up interest rates. At the same time, the government's fiscal plans are clearly expansionary. These inconsistencies are a worry.

It is also worrying that Dr Cullen has resisted suggestions that the government should act to avert a credit rating downgrade by Standard and Poor's, which could only be negative for New Zealand. In my view, a downgrade is not inevitable given the current economic outlook, and could not be blamed on the position the government inherited. The stated concerns of Standard and Poor's have also focused on the government's tax and spending policies, changes to the ECA, the increase in the tax rate and higher business costs impacting on competitiveness. All these concerns are forward-looking and within the government's power to allay.

What also strikes me as curious is that the government's general policy orientation seems to run counter to worldwide trends. The government expenditure share in national income has been falling steadily across OECD countries as a whole since 1993; in the most dramatic case, Ireland, it has fallen from around 50 percent in the 1980s to under 30 percent this year, according to the OECD. The OECD's latest *Economic Outlook* indicates that on a variety of measures countries like the

United Kingdom, Ireland, the United States and Australia are less regulated than New Zealand. Deregulation, privatisation, tax reductions, welfare reforms and other moves towards smaller government are worldwide trends, even in the case of governments that talk of 'third way' policies. The idea that New Zealand has been following some kind of economic 'experiment' which needs to be abandoned is sheer nonsense.

Just in the last few weeks, for example, I have noticed that the Labour government in New South Wales is promoting private sector competition in accident insurance; the Federal government in Australia plans to privatise its major remaining airport, Sydney, after the Olympic games, and China is floating 35 percent of Beijing International Airport; Germany, the Netherlands and Chile are privatising their postal services; India is deregulating its insurance market; Chile is selling its ports and water and sewerage utilities; Germany has deregulated its electricity market; the United States has finally decided to remove barriers to competition in financial services; Canadian farmers are demanding the abolition of the monopoly Canadian Wheat Board; the Italian government has sold the company that runs Italy's motorways; Australia is cutting its corporate tax rate to 30 percent, Germany to 25 percent and Ireland to 12.5 percent; and the United States is raising the retirement age for Social Security benefits to 67. These items come from just a random set of news reports; there are no doubt a host of other similar developments. I am not aware of any country that is planning a freeze on privatisation (which has led TransAlta to plan to exit New Zealand), raising top income tax rates, or contemplating some of the other moves that our government has foreshadowed.

To be sure, it is early days, and business should suspend firm judgments about the quality of the government's overall programme until a clearer picture has emerged. In its own interests and those of the country the business community must act responsibly, but that does not mean staying silent. Denying worrying trends does not build longer-term confidence in New Zealand. I am sure the business sector will extend goodwill to the new government and be happy to assist it with tasks such as sorting out the mess the previous government made of its electricity sector reforms. It will certainly not be taking the extraordinary partisan stance of the new leadership of the Council of Trade Unions which dedicated itself to "getting rid of" the previous government: this must surely condemn the CTU to irrelevance when the government next changes, as governments inevitably do. The flipside of this is that business will expect the government to act responsibly and in the overall

national interest rather than the interests of narrow constituencies, to listen to business concerns, and to show itself willing to modify unwise policies.

It should also be acknowledged that the government has won an election mandate, and is entitled to implement its core policies. Having such a right says nothing, however, about their merits: Sir Robert Muldoon secured a mandate in three successive elections, yet his policies were disastrous and ran the country into the ground. Our triple A credit rating was lost and will not be restored in the foreseeable future under current policies. In the Muldoon era, far too many people in business and the media who should have known better failed to criticise Sir Robert's foolish actions. Business leaders have a duty to do their homework and speak out responsibly to politicians and the public about measures that are likely to harm businesses, their stakeholders and the wider community. This is not a popular role, but it is hard to respect those who choose not to accept it, keep their heads down or leave it to the other guy. Public servants also have a duty to give governments frank, fearless and sometimes unpopular advice, and their performance in doing so is now more open to scrutiny.

In the final analysis, whether governments like it or not, businesses have to make their decisions according to the economic environment they find themselves in. If that environment is not business-friendly, and if businesses lack confidence, they will not invest or will take their business elsewhere. Likewise investment managers, whether domestic or offshore, have a duty to seek the best returns on their clients' funds and will shift money elsewhere if a country's outlook is unattractive. Short of reimposing exchange controls, which would be suicidal, governments are powerless to pre-empt those decisions. Similarly, highly skilled and entrepreneurial people are far more mobile in today's world, companies are scouring the world for talent, and the best and brightest will not stay long in countries that offer limited prospects. Particularly in remote parts of the world like New Zealand, governments must recognise these realities and work doubly hard to make their countries attractive places for people to work and invest.

So the government and the business community have close mutual interests in avoiding policy errors and taking New Zealand forward. Both want to promote a strong, cohesive, prosperous and fair economy and society. The minister of finance has stated a desire to see New Zealand's average annual growth rate raised to over 4 percent. During the election campaign the prime minister set a

goal of reducing the unemployment rate to below 3 percent. These are laudable and feasible but very challenging goals. They are goals that the business community can relate to, and the electorate will ultimately hold the government responsible for achieving them.

But the government will lack credibility if it does not produce a realistic strategy for achieving those goals or, worse, if its actions positively undermine them. Policies to tax more heavily the most able and productive and to re-regulate the labour market can only work against such goals. So too will approaches based on the belief that all problems can be alleviated by greater regulation and spending.

Right now, I have to say I do not understand the government's strategy for achieving its goals. Many of the policies announced to date risk taking New Zealand backward, not forward. They seem likely to harm rather than help its growth prospects. My answer to the question: 'Can we afford to replay the economic past?' is emphatically 'no'. Thanks to years of hard work, New Zealand now has a better structured economy but it has failed to keep up the momentum of change, its businesses still have a lot of work to do to achieve international best practice, and its outlook is far from secure. We can ill-afford to lose further ground. There is a large gap between New Zealand's current performance and its real potential, and the business community and the government must engage constructively over ways of bridging that gap.