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**THE CHEQUERED PATH OF ECONOMIC
REFORM IN AUSTRALIA AND
NEW ZEALAND**

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THE CHEQUERED PATH OF ECONOMIC REFORM IN AUSTRALIA AND NEW ZEALAND

This is not a good time to be talking in Australia about New Zealand. Although our economy is going through a cyclical upturn and grew by around 4 percent in the last 12 months, business confidence is low, international investment interest has fallen away, and there is a worrying outflow of people. The current account deficit and external debt are at risky levels.

A recent report by a London investment advisory firm assessed the situation bluntly:

We are switching out of the Kiwi dollar into the Aussie and we're staying out of New Zealand equities and bonds ...

We don't like the policies of New Zealand's new centre-left government. They are ideologically motivated and represent a significant reversal of the supply-side reforms that made New Zealand excel over the last decade ...

The opposition National Party seems in disarray ...

Global capital markets and the advent of the new economy increase competitive pressure on governments to shrink their economic reach and pursue low taxation and business friendly policies ... No such constraints apply to New Zealand in the mind of the new Labour-Alliance coalition ...

On our recent New Zealand visit two things stood out. One was the pervasive pessimism of business leaders. The second was that there was not one member of the young elite that didn't want to leave for Australia or other climes offering better career opportunities ...

Nemesis may take a while. Foreign capital may flow in to buy cheap equities ... But that's no reason for us to stay long in the NZ\$ in an age when the New Zealand government looks set to try and swim back up the river of history.

The government rejects that kind of analysis. Although it is a minority government, it persuaded a sufficient number of voters in last November's election that the policies that the Labour government of the 1980s initiated, and which were carried on by the National government of the early 1990s, were somehow 'extreme' and needed to be 'rebalanced'.

This view is, of course, nonsense. None of the so-called 'third way' (yawn) governments, with which our Labour Party likes to compare itself, is swimming against the tide of economic reform of the past two decades. President Clinton has overseen radical welfare reforms never contemplated by the Reagan administration.. The Blair government in Britain is largely

carrying on the Thatcher government's legacy; while trimming it in a few ways it has extended it in others. Even though continental Europe is still burdened by high taxes and regulation, France's socialist government has implemented more privatisations than its conservative predecessor. Germany is selling shares in its post office and cutting its company tax rate to 25 percent. And so on.

By contrast, since the election the coalition has increased New Zealand's top tax rate, determined not to reduce the share of government spending in the economy any further, called a halt to privatisation, frozen tariffs, restored the state monopoly in accident insurance, introduced labour legislation to promote the role of unions and collective bargaining, moved to reduce choice and reassert centralised control in education and health, increased the universal state pension and relaxed welfare administration. The deputy prime minister is promoting government-sponsored economic development projects such as a possum fur industry – the invisible hand is being given a possum skin glove. For Australians the crowning glory in this programme might have been last week's decision to proceed with plans to set up a state bank. No other contemporary OECD government is acting to restrict systematically the role and scope of markets in its economy in this way.

As this programme has unfolded, polls suggest many New Zealanders are having second thoughts. On my interpretation, the country was not voting last year for such a radical change of direction; much more it was voting out a tired, incompetent and directionless National Party. Many in business and indeed in the National Party itself think that the country would have been better off if National had lost office in 1996 – before it went into a coalition with Winston Peters' New Zealand First party.

Government ministers obviously think they are doing the right things, and much of the country still agrees with them, but the movement of mobile capital and labour is sending a clear signal that they have got it wrong. Those with a collectivist mindset talk of a 'capital strike'; they somehow think that investment decisions are coordinated by a capitalist equivalent of a trade union council whereas in fact they simply reflect the judgments of thousands of owners and trustees of capital about relative returns and risks. Young and enterprising people are voting with their feet. A typical example of their attitude is an e-mail I saw recently from a young New Zealander to a friend of hers in the United States:

In the nicest possible way: DON'T COME HOME! It's a disaster. Margaret Wilson's new employment bill is a shocker and unemployment will be a way of life when it's passed ... The NZ\$ is about US46c and [deputy prime minister] Anderton thinks that is good but interest rates are too high for his liking (the linkage has escaped him again).

Another working in Australia recently wrote:

I also regret to say that as a young person with aspirations for my future, remaining in New Zealand in the current environment was not a pleasant prospect ... The international environment is increasingly unforgiving of economies that do not embrace change, innovation, flexibility and other key drivers that have come to characterise successful economies such as the United States and Singapore ...

Although the direction of the current government plays some role in [my] feeling, it actually goes deeper than that. Watching 'winners' in New Zealand society having their reputations ruined by politicians and the media on the grounds of their success does not send positive signals to my generation, who are generally well educated, hope to succeed, and of course use remuneration as one of the measures of their success.

New Zealand cannot sustain a loss of investment interest and brains for long, or a Tasmanian future will be in store for it. Geographically peripheral economies need to have better policy regimes than those that are at the centre of world markets. Ironically, given the government's alleged concerns, the people who will suffer most if New Zealand does not stand out will not be those who are capable of being citizens of the world but the old, the unskilled and the immobile who will be left behind.

What has gone wrong? Interpretations of the paths that Australia and New Zealand have followed over the past 15 years or so have often been wide of the mark on both sides of the Tasman. Australians have sometimes viewed New Zealand as a model of economic reform and are puzzled as to why it has not done better. Many New Zealanders think that Australia has followed a different path with better results. Both views miss the key similarities and differences.

The reality is that Australia has been a slower but more consistent liberaliser than New Zealand. Australia largely scrapped import licensing in the 1960s, some 20 years before New Zealand. From 1975 to 1985 Australia's economic freedom rating improved (on the Fraser Institute measures, which may overstate the change) from 6.9 to 7.8 whereas, thanks to Muldoonism, New Zealand's rating remained about the same (6.2 in 1985 compared with 6 in

1975). By 1997, the last year for which ratings are available, both countries had moved to a similar score (New Zealand's rating was 9.1 and Australia's 8.6).

But the progress of New Zealand has been like that of a car with a recurrent fuel blockage. It moved ahead rapidly for a while (1984-88) in response to a genuine economic crisis, stalled and then moved forward again for a short period (1991-92). Then it stalled again and is now being put into reverse. By comparison, Australia seems to have been more like a yacht making steady progress despite being carried off course at times by unfavorable winds and currents. Reform in Australia has often been noisy, messy and compromised, but overall Australia has gone further and is staying the course better. New Zealand will pay a high price for its failure to achieve a sound and stable 'economic constitution', as a recent monograph by Wolfgang Kasper for the Centre for Independent Studies points out. By the time of the next election in 2002, New Zealand looks likely to have suffered a decade of lost opportunities.

Other indicators confirm this picture. Having achieved a high ranking in the international competitiveness league tables (9th position in 1995, well ahead of Australia in 21st place), New Zealand fell to 21st position in the latest survey while Australia moved up to 13th place). The two countries' positions on the economic freedom index must surely soon be reversed also. To take one key indicator of economic freedom, Australia has reduced spending by governments at all levels from 35 percent of gross domestic product (GDP) in 1994 to around 32 percent, according to OECD figures. In New Zealand total government spending is much higher at 40 percent of GDP, the same ratio as in 1994.

Both countries have lifted their economic performance. The OECD has assessed that as a result of economic reforms, New Zealand's economic growth potential has risen to around 3 percent per annum, about double what the economy was capable of sustaining during the 1970s and '80s. Work by the Productivity Commission suggests that the rate of productivity growth in Australia since 1993/94 has been double its previous average. It is unlikely that this surge in productivity would have occurred without reform. But as a result of New Zealand's policy slippage since the early 1990s, Australia has been doing better than New Zealand in recent years, contrary to the situation only 5 or so years ago when there was talk of the New Zealand dollar achieving parity with the Australian. The performance gap between the two countries now seems likely to widen in Australia's favour.

Given the present malaise in New Zealand, it would be nice to think that Australia was

continuing to add to its achievements and to provide a beacon of light for New Zealand. In some ways it still is: you are about to implement major tax reforms (although the compromises over the goods and services tax are regrettable); some states are progressing with electricity, port and rail privatisation; Australia is well ahead in establishing commercial water and roading operations; and deregulation of agricultural marketing is further advanced.

Yet in other respects Australia seems to be catching the New Zealand disease. It is baffling to understand how a government that came into power after so long in the wilderness, during which time it replenished its intellectual capital and cast off the failed practices and policies of the Fraser years, should have retreated so far and so quickly into the bunker and abandoned a reform agenda.

At least from 2000 kilometres away it has been painful to watch John Howard snuggling up to Chesty Bond, the abject capitulation to the carmakers, the overly complicated workplace reform, and the jettisoning of David Kemp's sensible tertiary education policy and Jocelyn Newman's overdue welfare proposals – in the last two cases at the first whiff of media grapeshot. Having stared down Pauline Hanson much more effectively than our politicians dealt with Winston Peters, the government now seems to be developing a myriad of spending programmes for every squeaky wheel in regional Australia. These can do little to moderate the fundamental economic forces to which regional economies must adjust, and will surely end up being another cruel hoax. Australia now seems to be behaving uncritically on greenhouse policy as though it is some deep green Scandinavian country. And when one hears talk that the new priority is social policy not the economy, there is a temptation to shout across the Tasman: "It's the economy, stupid!" Might Australia see a government that appears to be losing its way be replaced by a backward-looking opposition, and throw away hard-won economic gains? The New Zealand parallels seem stark.

Why have New Zealand and Australia caught these diseases to varying degrees, and how can we throw them off? It is easy to find excuses. In some respects political institutions in both countries don't help; the adoption of the mixed-member proportional electoral system in New Zealand has conferred on us some of the 'blessings' of the Australian senate. The downfall of reformist governments can be a blow to confidence, although arguably the Kennett defeat owed less to voter disagreement with overall policy directions than to a number of dubious projects and the way an otherwise admirable premier treated many critics or doubters as fools.

Then there is the excuse of reform fatigue. But there does not seem to be much evidence that large numbers of people have decided to resist reform as a result of careful consideration of the issues. Not many people are prepared to argue that stopping reform would result in higher living standards. Most people want improvement in their lives, and improvement requires change. Australians and New Zealanders are fast adopters of new technologies like computers, mobile phones and the internet because they see the benefits of them, even though they bring profound changes to workplaces and lifestyles. Why should they not support changes to policies and institutions if the benefits are explained fully, simply and intelligently?

Perhaps therein lies the rub. Towards the end of his term as chairman of the Industry Commission, Bill Scales observed:

As I travel around the policy forums of this country I am struck by the degree of backwardness in many of the arguments that I hear. Arguments that were fought and lost in the 1970s are appearing again. And the level of understanding that characterised earlier debate seems to have fallen away.

The patron saint of this Society was Bert Kelly, whose efforts over many years were a supreme example of the power of one person in demolishing false ideas and promoting better ones. When Bert began his career, free trade was a despised heresy; today it enjoys widespread support. On the other side of Australian politics Peter Walsh performed a similar role. Where are the Kellys and Walshes today when we need them? In New Zealand in recent years we have had no politicians and few media commentators who have challenged the country to build on its partial reforming success and warned of the risks of stalling or going into reverse.

In the end it all comes down to public understanding. Politicians are society's leaders and communicators. They must address the things that concern people, explain why they are happening, and persuade them of the best responses. Regional Australia and New Zealand will decline more rapidly if we protect industries in our cities, make our labour markets less flexible and fail to achieve high levels of international competitiveness. New technology and globalisation are putting a premium on skills and stretching the income gaps that worry the community, but if we focus on inequalities rather than on helping the poor and if we set our face against such trends, everyone will be worse off, especially those on low incomes. We either adjust or we fall further behind leading countries.

If battles like these are not fought and won, politicians will allow a perception to develop that compassionate policies are at odds with 'economic rationalism', which is not only wrong but will make the task of future reform harder. They must make the case for personal advancement through initiative and hard work in a society that provides opportunities, as opposed to one with an anti-success culture and a focus on redistribution. The only place where success comes before work is in the dictionary.

In taking the high road, reform-minded politicians ought to be able to expect support from business. Politicians like Bert Kelly and Roger Douglas did much to wean business away from state privileges and enjoin their support for free trade and open markets. But the lessons have to be taught anew in each generation.

In both countries today we are hearing nonsense about trade reciprocity. Nick Minchin deserves praise for the stand he took against interventionist policies at the Innovation Summit. Simon Crean seems to be picking up New Zealand's current reactionary ideas about labour market policies. In the debilitating environment in New Zealand some in industry are calling for subsidies like R & D tax concessions and some in farming are calling for regional handouts and subsidised telecommunication services. Other business leaders have fortunately not succumbed to such temptations. They have continued to resist more interventionist policies and defended the open and competitive economy that has benefited consumers by forcing businesses to meet their needs. In a bizarre turn of events, however, such business voices are being painted as self-serving and as a constituency that has nothing to do with the creation of jobs and the incomes of ordinary people. Politicians and business people must work together to counter such confusion.

In the final analysis, politicians can face the inescapable challenges of economic change in two ways. One way is to say to the electorate: "We understand your concern that change might be disruptive, so we won't introduce further reforms and indeed we will roll back some existing ones". The alternative is to say something like: "The future prosperity of people in this country depends on how we adjust,

individually and collectively, to changes in the international economic environment. We therefore propose to carry on doing things that will let individuals and firms take better advantage of the opportunities in the world around us".

The choice between these approaches may appear to be a choice between greater security on the one hand and greater prosperity on the other. In reality it is nothing of the sort. There are huge risks in attempting to preserve the status quo in a rapidly changing world. Either we accept the challenges and rewards of steady, continuous change or we face relative national decline and ultimately serious economic and social crisis.

Those of us who value freedom, prosperity and security thus have no choice but to continue to make the case for continuous policy improvement. In recent years the going has become much tougher in Australia and New Zealand. But we should recall that for most of his time in parliament Bert Kelly fought pretty lonely battles, and it may take time for liberal ideas to get a better hearing again.

Certainly we must hope for a turn of fortune. Around the world liberal ideas are continuing to spread. Against all international experience, it is just not credible to believe that the current trends towards more intrusive and over-stretched government in New Zealand will make it a more prosperous and fairer place. We may have to learn some hard lessons over again before the electorate recognises that success in the modern world requires smaller, better government and greater personal and economic freedom and responsibility. It would be a further setback for us if supporters of the cause of reform and the ideas of Bert Kelly failed to carry on defending them in Australia.