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**BENCHMARKING INTERNATIONAL BEST
PRACTICE IN PUBLIC POLICIES**

ROGER KERR
EXECUTIVE DIRECTOR
NEW ZEALAND BUSINESS ROUNDTABLE

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BENCHMARKING INTERNATIONAL BEST PRACTICE IN PUBLIC POLICIES

In businesses today it is commonplace to benchmark practices and performance against other companies, both at home and abroad. Typically firms aspire to best practice as a yardstick, wherever this is feasible.

We can do the same thing with our public policies. While local circumstances need to be taken into account, by and large policy lessons run across countries, if only because human behaviour is much the same worldwide. Central planning doesn't work any better in North Korea or Cuba than it did in the Soviet Union. So I thought it might be an interesting exercise to see how New Zealand policies in key areas stack up against what might be regarded as best practice around the world.

The motivation for such an exercise is obvious. There is again a widespread feeling in the community that New Zealand needs to do better economically. One manifestation was the Knowledge Wave conference, which was fundamentally about faster economic growth. Political parties are talking about growth rates that would dramatically lift New Zealand's position in the Organisation for Economic Cooperation and Development (OECD) rankings.

Achieving much faster growth would require major changes in people's attitudes and behaviour, in business performance and, above all, in public policies. The quality of policies and institutions – such as secure property rights, sound political arrangements and the rule of law – is critical for economic performance; it dominates everything else.

New Zealand's economic performance improved sharply following the two waves of reform in the 1980s and early 1990s. For the '90s as a whole, average per capita incomes grew by 1.7 percent per annum in real terms, twice the 0.8 percent rate recorded over the last three decades on average. That improved growth rate is virtually identical to that of the OECD as a whole in the last 10 years, so the reforms seem to have arrested our earlier decline. However, little more has been done for

the better part of a decade, some recent moves have been negative for growth, and we are not on a path to close the gaps with higher income countries.

How should we think about policies for better economic performance, and go about benchmarking our policies with those of other countries? A few preliminary observations are in order.

First, the starting point in thinking about any policy should be the best insights from economics and related disciplines, not what other countries do. No country has an ideal set of policies and even very successful countries have many bad ones – protectionist agricultural policies in rich countries are just one case in point. Governments typically govern in the interests of particular constituencies that vote for them rather than in the overall public interest. The public interest should be regarded more as a constraint on their behaviour than a goal: if they neglect it unduly the country will fare poorly and they will lose office. Thus it is very often possible to devise better policies by using sound economic principles than by selecting policies from a menu of those in place around the world at any point in time. There were few models 20 years ago, for example, for independent central banks or programmes of privatisation. Nevertheless, many people want to see the insights of economic thinking confirmed in practice before being persuaded by them. This is perfectly understandable. Hence the value of looking at best practice, or at least good practice, elsewhere.

Secondly, the most important benchmarks are the soundness of the overall direction of policy and a consistent economic framework. Success requires getting a lot of things right, and making continuous improvements to at least match advances elsewhere. Thus a study by Phil Barry for the Business Roundtable earlier this year looked at New Zealand's current public policy directions in an international context, and concluded that they are contrary to those observed in most, if not all, OECD countries over the last two decades. Indeed David Henderson, a former senior OECD official, wrote in a paper earlier this year that "There are only a few countries where the trend is in the opposite direction: examples are New Zealand, Venezuela and Zimbabwe". Other countries have maintained programmes of economic liberalisation whereas New Zealand is swimming against the tide with moves to

higher government spending and taxation, government ownership of industry, greater regulation and more 'hands on' intervention.

Thirdly, to do as well as high performing countries we have to have policies that are better than theirs, not just the same. We need to create competitive policy advantages to offset our disadvantages of size and isolation. There is little point in matching Australian tax rates or adopting Australian business regulations, for example, unless they are the best possible model: we must strive to do better. Otherwise the attractions of its larger economy will be compelling for many businesses. I think this is an uncontroversial proposition: the same point has been made by the OECD and *The Economist* in commenting on New Zealand, and echoed by the minister of finance and other politicians.

A final reason for embarking on this exercise is to challenge the view that policy changes which the Business Roundtable and others have supported are somehow 'radical' or 'extreme'. As we shall see, policies we have advocated have been implemented in many comparable countries.

Against this background, let's benchmark New Zealand against good international practice in a range of areas that are important enough to make a difference to overall national performance. My list comprises monetary policy, public spending, taxation, privatisation, trade policy, labour markets, education and health, and welfare. I do not claim that this list is comprehensive: it does not include important institutional arrangements like the electoral system, protection of property rights or land use regulation, for example. Nor do I claim that all the policy benchmarks I have chosen are the world's best, still less the best that could be devised. My argument is simply that they offer major advantages over New Zealand's current arrangements.

With respect to **monetary policy**, little needs to be said. New Zealand's current institutional arrangements, notably an independent central bank charged with keeping prices stable, are in line with world best practice, as are the Reserve Bank's operating procedures. The only medium-term alternative worthy of consideration is the adoption of a common currency, such as the Australian or United States dollar.

This is a serious option, but only in the context of a much more flexible economy and perhaps a broader relationship with the United States, including a free trade agreement.

On **public spending**, New Zealand is well short of best practice. While the quality of spending matters, the total level should be related to the government's role of ensuring the provision of core public goods – such as a legal system, defence and public health – and a social safety net. Spending by central and local governments in New Zealand currently runs at around 40 percent of gross domestic product (GDP), a level far in excess of that needed to discharge core functions. I know of no country that has achieved sustained per capita income growth of 4 percent a year – the kind of rate needed if New Zealand is to move up the OECD rankings – with a 40 percent government sector share of the economy. Benchmark countries for New Zealand should be Hong Kong and Singapore, where government spending is below 20 percent of GDP, or the United States and Ireland, where it is around 30 percent. The smaller size of government in these economies is undoubtedly a major factor in their better economic and social performance.

High government spending by definition means a high tax burden. For any given level of government spending, the **tax policy** issue is how best to raise the required amount of revenue. New Zealand has a well-designed consumption tax in the form of GST, but our income tax is not best practice. As the current Tax Review has argued, New Zealand should be moving to a lower, flatter income tax structure, not a more progressive one. Hong Kong is a model in this regard: it has a company tax rate of 16 percent and a top personal tax rate of 15 percent. Russia has introduced a flat income tax of 13 percent this year. New Zealand needs to 'stand out from the crowd' to attract internationally mobile capital and labour and should be aiming to get all income tax rates down to below 25 percent.

New Zealand was a latecomer to **privatisation**, but for a time made significant progress. In line with experience elsewhere, privatised firms have generally achieved productivity improvements and contributed to growth. While privatisation came to a halt and has now been reversed in New Zealand, it has proceeded apace around the world. Electricity is now mainly a private sector

industry internationally whereas the state remains dominant in New Zealand. Few if any countries have a state monopoly accident insurance business. Germany is privatising its post office as well as many of its hospitals. Australia has privatised most of its airports and the South Australian government is privatising its port company and has franchised its water supply. The list goes on. Not all privately owned companies succeed and not all state-owned enterprises are failures, but the evidence is clear that, on average and over time, private firms outperform state firms. This is the essential case for privatisation: governments should not bet against the odds.

Under the heading of **trade policy**, the case for free trade is firmly established in economics and, with some exceptions, trade barriers around the world are gradually coming down. Benchmark countries for New Zealand include Hong Kong and Singapore which have had free trade for years. Switzerland is largely a free trader, apart from agriculture. Other small countries like Ireland and Sweden have benefited from having relatively open economies. The government's decision to freeze tariffs makes no sense from an economic perspective: the sooner New Zealand gets to free trade the better.

New Zealand went a long way in the direction of a freer **labour market** but with the re-regulation of employment arrangements by the Employment Court and the recent Employment Relations Act, New Zealand no longer stands out from the crowd. Experienced practitioners are advising companies considering whether to locate in Australia or New Zealand that Australia's labour laws overall are now better than ours. This is a huge setback, since Australia's arrangements are still far from best practice. Much better models for New Zealand are Hong Kong and Singapore, or the United States, the United Kingdom and Switzerland, whose regimes intrude much less on the freedom of parties to negotiate their own contracts. What is particularly important in new and innovative industries, such as in the high-tech sector, is freedom in hiring and firing so that firms can cut their losses and terminate contracts if risky ventures don't pay off. Many observers have remarked that the freer labour markets in the United States have given that country competitive advantages over European countries which have maintained rigid

employment protection rules and suffered higher unemployment. Unfortunately, New Zealand has been heading down the European path.

When it comes to **education** and **health**, which are the source of perennial dissatisfaction in New Zealand, the key problem to focus on is the public monopoly. The government has a dominant role as owner, funder and regulator at the compulsory levels of education, and in tertiary education and secondary medical care – though not in primary (general practice) medicine, which works well. Despite the best efforts of many professionals, all the problems of monopoly are apparent in these sectors – high costs, one-size-fits-all services, queues and waiting lists, and rigid, disputatious employment arrangements. We saw impressive gains from competition when the ACC monopoly was briefly removed.

In respect of **compulsory education**, an outstanding model is Ireland. Most schools in Ireland are private – there is no obvious reason why the government needs to own all schools – but Irish schools are funded on more or less an equal basis. Education is traditional, teacher-centred and meritocratic, with an emphasis on external examinations. The result is a workforce that is literate and strong in maths and sciences, and thus attractive to international companies. The Netherlands, Denmark and Sweden are also countries that have avoided or abandoned a monopoly education system; they have a strong private school sector and/or roughly equal funding of state and private schools. In the United States the school choice movement continues to gain ground through charter school initiatives, voucher schemes, for-profit education and homeschooling. Australia has an important private sector and outperforms New Zealand in international comparisons. Education standards in Hong Kong and Singapore are also high. A feature of these countries is the contribution of fees, particularly in higher education. Government expenditure on education is around 3 percent of GDP in Hong Kong and 2 percent in Singapore, compared with 6 percent in New Zealand.

For **tertiary education**, particularly universities, the US system as a whole is widely regarded as the best in the world (although there are, of course, weak institutions in such a large and diverse system). The key characteristics of the US system are strong competition between institutions, the important role of private universities

and endowments, the significant proportion (around 50 percent) of tuition costs that is met by students themselves, and rigorous rating of institutional performance. These features are generally lacking in New Zealand, and current policy directions are away from competition and private provision.

Around the world, what stands out in **health** is the common problems of national health services in countries such as Britain, Canada, Ireland and New Zealand. Canada's move to a national health system was once regarded as putting it on a better footing than the United States, but few people still hold that view – some waiting lists are as long as five years and there is a constant flow of Canadians across the border for treatment in the United States. The quality of US health care is typically high, but the system is plagued with regulations that make for excessive costs. Perhaps better models for New Zealand are those of some European countries where private insurance plays a significant role and there are many private providers. In France – a country that scores well in international comparisons – one third of the hospitals are private, in Germany half and in the Netherlands 85 percent. Sweden has been moving away from a national health service monopoly.

Finally, for **welfare** reformers, the stand-out country in recent years has been the United States, and its experience has forced a rethinking of welfare policies worldwide. The driving idea of the US reforms was that, for most people, work not welfare should be the norm – open-ended reliance on welfare was unacceptable and not in the overall interests of recipients. Intensive efforts to get beneficiaries back to work, coupled with time limits on assistance, have halved welfare rolls and improved social indicators virtually across the board. The emphasis is now shifting to the welfare role of private and charitable institutions. Family and private assistance also have a much greater role in Asian countries, which have not developed large-scale welfare states and the problems that go with them – their rate of family breakdown, for example, is a fraction of ours. Australia has a more restrictive approach to welfare than New Zealand, including on retirement income which is subject to means testing and accounts for a lower proportion of GDP.

As we look across this range of key policies, some common lessons and practices stand out. Countries with big governments and high taxation are struggling to

grow. In recent years the majority of OECD countries have reduced the government spending share of their economies and cut marginal tax rates – New Zealand is one of the few exceptions. Governments have focused on important core roles but have privatised commercial businesses and allowed more scope for private competition in formerly state-dominated areas. Free trade and open and competitive capital and labour markets are vital for growth. Labour market and welfare reforms are the key to achieving full employment and promoting many other improvements in social indicators.

The examples of best practice that I have mentioned come from countries with centre-right and centre-left governments alike. Ireland's very successful reforms were driven by the Progressive Democrats, the equivalent of the ACT Party in New Zealand, but have been embraced by all the main Irish political parties. The Reagan and Thatcher reforms in the United States and the United Kingdom were carried on by the Clinton and Blair administrations. I know of no successful country that is not still moving in the general direction of greater economic liberalisation.

I therefore conclude that if New Zealanders and New Zealand political parties are serious about wanting higher living standards and returning to the top half of the OECD rankings, we will have to bring our policies and institutions into line with those of the top performers. Indeed we will have to do better to offset our natural disadvantages. Political parties should be challenged to align their programmes with their goals.

There are many superior policies around the world that we can use as benchmarks. New Zealanders clearly aspire to the better economic, education, health and welfare outcomes achieved by the countries I have mentioned. There is no reason why we cannot achieve similar outcomes, but major changes to adopt best practice models are required. As Reserve Bank governor Don Brash said at the Knowledge Wave conference, "Minor changes at the margin simply won't do the trick".