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WELLINGTON NORTH ROTARY CLUB

'BE MORE LIKE AUSTRALIA'

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'BE MORE LIKE AUSTRALIA'

During the election campaign we have heard a lot of claims about "the failed policies of the 1990s". These claims are nonsense, and they have not been effectively countered.

In the 10 years to 2002, New Zealand's annual average growth rate was 3.3 percent, according to the latest International Monetary Fund (IMF) figures.¹ This was the same growth rate as that achieved by the strongly performing US economy in the period, and above the advanced country average of 2.7 percent. This means that New Zealand is producing nearly 40 percent more goods and services than it was 10 years ago. Some failure.

By contrast, the economy grew by only 1.8 percent on average in the 10 years to 1992, compared with average growth of 3.3 percent in the IMF's group of advanced economies.

In addition, our employment growth has been much stronger in the past 10 years, the unemployment rate has been cut in half, productivity has improved, inflation has been curbed and public debt is now much lower.

The economy's performance was strongest in the first half of this period. Real gross domestic product (GDP) per head increased by a remarkable 13 percent (calendar year basis) in the five years to 1996. Subsequent economic performance has slipped with the end of a reformist programme after the 1993 election, the advent of MMP and large increases in government spending, as well as adverse events such as the Asian economic crisis.

However, it is not my intention today to elaborate on this analysis, or on the strengths and shortcomings of past policies. The reality is that most of the reforms have been broadly accepted and remain in place. For all the criticism, the present government has only modified a few of them in limited ways, though regrettably most of the changes have, in my view, been in the wrong direction. Rather than rake over the past, I want

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World Economic Outlook, International Monetary Fund, October 2001.

to look at the more important and practical issue of where New Zealand should be heading now.

On this there would appear to be considerable common ground between both supporters and critics of New Zealand's reforms. Even the critics argue that New Zealand should be 'more like Australia'. That prescription is also in line with the advice that the Organisation for Economic Cooperation and Development (OECD), the IMF and others have given to the government.

Australia has certainly done well since it embarked on a programme of structural reforms with the election of the Hawke Labor government in 1983. According to the same IMF source that I quoted earlier, Australia's economy grew by an average of 3.1 percent in the 10 years to 1992 and by 4.1 percent in the decade to 2002. Australia looks likely to continue to achieve annual growth of 3-4 percent a year whereas New Zealand's outlook is perhaps 2-3 percent. This is a significant difference. So it is certainly worth looking at lessons from Australia's experience.

To do so adequately would require a long narrative, but let me give you a quick sketch. The parallels with New Zealand are striking, but there are some important differences.

A century ago, average Australian and New Zealand incomes were among the highest in the world, along with countries such as the United States, Britain and Argentina. Both countries had achieved their wealth with open economies, governments that were small by today's standards, and the development of resource and land-based industries that reflected their comparative advantages.

From the early part of last century, however, policies in both countries became more inward-looking. Tariffs were imposed, followed by import quotas. Labour markets were regulated and centralised wage-fixing was introduced. Government ownership of industries expanded, as did state welfare from the 1930s. By the middle of the century the terms 'fortress Australia' and 'fortress New Zealand' were being widely used.

In the post-war years, the effects of poor economic policies started to become apparent in both countries. The familiar talk about 'slipping down the international league tables' began around this time. A 1962 Monetary and Economic Council report noted that New Zealand had the worst productivity record of any advanced country since the war.

The degree of slippage was somewhat less in Australia than New Zealand. Bad policies had not been taken as far, and Australia made earlier efforts to reverse the slide. Most import quotas were eliminated in Australia in the 1960s, and tariffs were cut by 25 percent by the Whitlam government in the 1970s. Nevertheless, both countries suffered from so-called 'stagflation' in that decade as the Fraser and Muldoon governments persisted with inward-looking, big-spending and inflationary policies. New Zealand was more affected than Australia by Britain's entry into the European common market.

The real changes began in Australia with the election of the Hawke government in 1983. It is instructive to look at events from that time to the present a little more closely.

Reacting to the mess inherited from the Fraser government, the Hawke government began a radical break from the past. It floated the exchange rate, deregulated interest rates and progressively freed up the financial sector. Quota restrictions were removed and a programme of tariff reductions was put in place. Industry regulation and subsidies, including a lot of agricultural marketing regulation, were scaled back. Commonwealth spending was cut from 30 percent of GDP at the time of the last Fraser budget to 24 percent by 1989. Budget surpluses were achieved towards the end of the decade, although the gains were later squandered. Tax reforms, including an imputation system for company tax, were introduced.

These changes were generally supported by the Liberal Party, which was ashamed of its previous record. Australia had the good fortune to enjoy a government and an opposition that were prepared to accept some basic economic realities.

The main unreformed area was the labour market. The Hawke government promoted a tripartite corporatist 'Accord' with unions and employers to limit prices and wages. Critics of New Zealand's labour market reforms argued for a similar approach here, but the Accord didn't work and has long since been abandoned.

The Keating government, elected in 1993, extended the reform programme with more corporatisation and privatisation, some further tax reform and a national competition policy aimed at reducing barriers to competition in internal markets. The Kennett government in Victoria pursued a more radical programme, drawing heavily on New Zealand experience, to reverse the fortunes of what had been a declining state. Over the 1990s most other state governments moved on broadly parallel paths at a slower pace.

On its election in 1996, the Howard government faced a deteriorating fiscal position, and one of its main achievements has been to restore and largely maintain budget surpluses. It has also put in place disciplines along the lines of our Fiscal Responsibility Act 1994 and Public Finance Act 1989. The government has implemented several packages of workplace reforms which have largely decentralised employment relations and wage fixing, continued with privatisation, and introduced a goods and services tax (GST). Australia has followed New Zealand in giving its Reserve Bank an explicit inflation target. The two central banks now operate monetary policy on a very similar basis, particularly since our bank followed Australia's in using an official cash rate as its main monetary lever.

Looking at the period since 1983 in the two countries as a whole, I think the following general points stand out.

First, the fiscal and monetary stabilisation and structural reform programmes have been remarkably similar in the two countries, although the timing was often different. Some of New Zealand's reforms have been of higher quality than Australia's, which suffered in some cases from political compromises – GST is a case in point.

Secondly, Australia's programme was more gradual than New Zealand's, which was largely concentrated in the Lange-Douglas and Bolger-Richardson periods, but

Australia had less long-term economic damage to undo and did not have to confront an economic crisis. People will continue to debate the merits of speed versus gradualism, which is as much a political as an economic issue, and is in any case largely irrelevant to future policy choices.

Thirdly, and perhaps most importantly, there has been more continuity in Australian policy. The political consensus for change has been stronger, and there has been limited backsliding despite changes of government at federal and state levels. Indeed, by contrast with New Zealand's record of stop-start reform and U-turns in policy direction, Australia has adopted a remarkably consistent, coherent and credible strategy of economic reform over the last two decades. Australia and New Zealand have both achieved high (and similar) rankings in the international indexes of economic freedom, but Australia is continuing to move up the rankings whereas New Zealand is moving down. This is not a good augury – economic freedom and economic performance are closely related. Ill-judged tampering with a country's economic constitution comes at a high price, particularly in respect of business investment.

Few observers doubt that Australia's improved economic performance is primarily due to the post-1983 reform programme, just as New Zealand's earlier reforms explain much of New Zealand's recent growth and the Thatcher reforms turned around Britain's economy. Advantages Australia enjoys which some people point to, such as its larger market size, plentiful natural resources and broader industry structure, did not prevent its earlier relative decline. And I know of no reputable commentator who attributes Australia's success to 'hands on' industry policies.

Overall, my judgment is that Australia's economic framework is in better shape than New Zealand's, and has been for some time. New Zealand possibly had an edge in some areas in the early to mid 1990s, and was outgrowing Australia in that period, but Australia is now better placed to prosper.

Of the policy areas that are most important for economic performance, I would say there is little difference between New Zealand and Australia today on monetary policy, financial market regulation, trade policy (tariffs are at similar levels), and regulation of

most product markets. New Zealand possibly retains an edge on labour market regulation. However, the gap is narrowing and the federal government is trying to deregulate further while New Zealand is going in the opposite direction. For example, unions now have a monopoly on negotiating collective agreements in New Zealand whereas more than 10 percent of collective agreements in Australia are negotiated without union involvement.

By contrast, I think Australia has the edge in several key areas.

- Total government spending, and hence the overall tax burden, is considerably lower in Australia than in New Zealand as a proportion of the economy. Even though Australia has governments at federal, state and local levels, the ratio of total government spending to GDP is around one third in Australia compared with around 40 percent in New Zealand. High spending and taxation levels are a drag on any economy. New Zealand simply cannot achieve sustained 4 percent plus growth rates, as advocated by most of our political parties, with so much lead in its saddlebags.
- Australia has been one of the world's most active privatisers in recent years, whereas, uniquely in the OECD, New Zealand has halted privatisation and made some opposite moves. With the sale of Sydney airport and the prospective sales of its remaining stake in Telstra and Medibank Private (a health insurer similar to ACC), the federal government will own only one significant business, Australia Post. State governments, all of which are now Labor, have also sold many businesses, including many electricity assets and some ports.
- Australia is well ahead of New Zealand in operating infrastructure industries like roading and water on a commercial basis, with toll roads, public-private partnerships and user charges.
- Australia relies on private funding and provision of health and education to a greater extent than New Zealand. Over 30 percent of Australian children attend non-government schools, compared with around 4 percent in New Zealand (15 percent if integrated schools are included). Many of the state governments are actively extending the role of the private sector. The Labor governments in New South Wales and

Victoria, for example, are looking to channel private money into public schools and hospitals, as well as public housing.²

- Australia's welfare arrangements are generally tighter and relatively less costly than New Zealand's. Its retirement safety net is targeted, not universal, with both income and assets tests. (By contrast its compulsory super regime and tax concessions are not attractive policies in my view.) Only two thirds of spending on retirement incomes, health and education in Australia is government spending, compared with almost 80 percent in New Zealand.

If New Zealand were to 'be more like Australia' to lift its economic performance, I believe these are the main areas that stand out. We would also do well to study features of Australia's culture that are more favourable to business 'battlers' and entrepreneurial wealth creation.

Currently, New Zealand is moving in Australia's direction in few, if any, of the key policy areas. Instead, it is adopting elements of Australian business law, which is generally more restrictive and costly, at a time when Australia is looking at moves in the opposite direction, at least with its equivalent of our Commerce Act. Nor do I think the adoption of a common currency would have much to offer New Zealand given its present policy settings – Tasmania's experience certainly shows that a common currency is no silver bullet.

Australia is into its eleventh year of economic expansion, outperforming other major industrialised economies. As a recent editorial in *The Australian* put it, this record:

... is a legacy of the economic reform agenda kick-started in the mid-1980s by the Hawke-Keating governments, then taken up by John Howard and Peter Costello. Liberalising much of the domestic economy and opening it up to global competition has produced results. As a nation, we should pause to reflect what would have happened without this reform agenda of the 80s and 90s. We all would be much poorer. Unemployment and inflation both would be higher. The sharp fall in the \$A would have fed into a vicious cycle of higher inflation rather than been absorbed as a boost to national competitiveness. We would have had much less to spend on social

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'Going private: a \$20b shake-up', *Australian Financial Review*, 11 February 2002.

services such as health, education and roads. The poor would be much worse off.³

With its more comprehensive set of economic reforms, Australia has reversed its long-run downward trend in relative living standards. New Zealand has at best stabilised its fall down the OECD rankings – its growth outlook is similar to that of many European economies – but it is not catching up.

Small differences in growth rates can make a big difference over time. At \$NZ57,000, average Australian incomes are already 30 percent higher than New Zealand's average of NZ\$44,000 on a purchasing power parity basis. If GDP per person grew by 3 percent in Australia but only 2 percent in New Zealand, the gap would widen to 44 percent over 10 years and 59 percent over 20 years. The relative attractiveness of Australia as a place to work and do business would increase further; there would be a giant sucking sound as firms and mobile New Zealanders migrated across the Tasman.

Australia does not look like resting on its laurels. The Howard government was re-elected last year, and the Labor Party, which put forward a somewhat backward-looking programme, is now in considerable disarray. Even though its record on economic reform in its last term was mixed, the government seems likely to press on. Prime minister Howard told a German audience earlier this month that "once a government loses some of its appetite for economic reform, it loses some of its rationale for existence." If and when John Howard steps down in favour of Peter Costello, there may be a new impetus to reform. Many business and media voices in Australia are calling for a more vigorous programme.

Instead of moving in Australia's direction, New Zealand is by and large moving further apart in economic policy and other areas. Australians seem to see this more clearly than New Zealanders. One commentator recently wrote:

Australians need only look across the Tasman to New Zealand to see what happens when you open up an economy, and then retreat.⁴

Another said:

³ *The Australian*, 11 March 2002.

⁴ George Megalogenis, *The Australian*, 18 February 2002.

We are right to shun identification with our under-achieving and unreliable cousins across the Tasman.⁵

New South Wales Labor Premier Bob Carr was recently reported as follows:

Carr does not want Australia to replicate New Zealand Labour's performance – a strategy, he says, that has turned back from economic competitiveness.⁶

There have been many similar comments. Other policy differences between New Zealand and Australia – from defence issues to the Kyoto Protocol to the approach to a free trade agreement with the United States, where Australia wants to go it alone – are also affecting the wider relationship. These are not happy developments.

Perhaps the final point to make is that Australia is no copybook example of economic management – it could be doing much better. For example, it badly needs more labour market reform to lower its unemployment rate; its high marginal tax rate and the Australian Wheat Board monopoly are absurd policies; and it is prone to 'think big' style indulgences with major projects. Moreover, New Zealand should be striving for superior policies to Australia to offset its disadvantages of size and location – although these should not be overstated. Instead there has been general policy deterioration since the early to mid 1990s. With the exceptionally favourable circumstances of the last couple of years, the economy should have been growing by 5–6 percent a year as it was in 1993 and 1994. Regrettably, with the weaker policy framework, we have been getting only around 3 percent growth, and New Zealand is showing no signs of moving back up the OECD league table.

In the election campaign there has been a lamentable absence of debate about the fundamental economic direction of the country. Australia's policy direction is in line with mainstream OECD practice: New Zealand is going the opposite way. Can New Zealand really succeed by walking a different path from the rest of the world? In the next parliamentary term, it must be hoped that political parties will be challenged more vigorously to adopt policies that match their goals. 'Being more like Australia' is not the ideal policy prescription but in many respects it would be a very good start.

⁵ Greg Sheridan, *Dominion Post*, 22 July 2002.

⁶ *Australian Financial Review*, 29 January 2002.

