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TRANS TASMAN BUSINESS LEADERS CONFERENCE

WORKING TOGETHER: DOING IT BETTER

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WORKING TOGETHER: DOING IT BETTER

To harmonise or not?

The topic of this session is 'Working Together: Doing it Better'. While the title has obvious appeal given New Zealand and Australia's long tradition of working together successfully in the military, diplomatic and even on occasion in the sporting arena, it tells only half the story when it comes to the design of public policy.

Yes, Australia and New Zealand should work together in the area of public policy where such cooperation delivers the best regulatory institutions and policies. But if one of us – whether New Zealand or Australia – wants to head off and introduce poor or second-rate policies, should the other be forced to tag along?

And yes, we should aim to do better. But I would like to suggest we raise the bar. Our aim shouldn't be just to do better. Why shouldn't New Zealand and Australia aim to have the very best regulatory environments in the world? In designing New Zealand's goods and services tax (GST) the 1980s Labour government sought and achieved an outcome which is probably the best in the world. (In framing its own GST much more recently, Australia didn't quite make the grade.)

As things stand today, in many areas of public policy New Zealand could do better by adopting Australia's policies and policy directions. Water management; greater choice, competition and private sector participation in education; and unfair dismissal regulations are just three examples. However, the primary aim of domestic policy should be to introduce the best policies that each country can. If each country achieves a gold standard, our policies will naturally converge over time. Most importantly, we will converge with first-rate rather than second-rate policies. And because institutions and policies matter, we can be confident of enjoying first-class, rather than second-class, standards of living as a result.

Harmonising our policies for harmonisation's sake would be a mistake. A few years ago the New Zealand government was under considerable pressure to adopt Australia's policy of mandatory country-of-origin labelling. To its credit the government declined to go along with what would have been a costly policy. Interestingly, Australia is now considering removing its country-of-origin labelling requirements. The push to align New Zealand's medical products regulation with Australia's very bureaucratic regime also seems misguided, and the industry and several parties in parliament are rightly resisting it.

I would not wish to rule out harmonisation completely. There can be benefits from harmonising New Zealand and Australia's policies, especially in reducing transactions costs for businesses and households. However, these and other benefits should be weighed against the costs on a case-by-case basis. As a 2004 study by economic consultants LECG and ACIL Tasman concluded, the benefits of harmonisation might tip the scales in favour of harmonisation if one or other countries' policies are close to first-best.[1] However, it wouldn't make sense otherwise.

Reviewing regulation

There is enormous potential for New Zealand to do a lot better in its public policies. Our prime minister announced at the opening of parliament this year that the government would be reviewing regulation. She said that "feedback from business suggests that higher quality regulation would lead to more growth and investment – and we want to engage with business on how to achieve that."

The prime minister is right to be concerned about the consequences of current regulatory policies for growth and investment. The Reserve Bank is predicting less business investment over the next few years and a falling economic growth rate. Roderick Deane is one business leader who has been speaking out about the link between this outlook and regulatory excesses. He has pointed to problems with the Commerce Act, local

[1] 'New Zealand - Australia Economic Interdependence', ACIL Tasman and LECG, paper prepared for the Ministry of Economic Development, May 2004.

government legislation, the Resource Management Act, the Employment Relations Act, the Kyoto Protocol, regulation of the banking, telecommunications and electricity industries, and company takeover regulation.

The fact that World Bank surveys have found that, on a range of criteria, New Zealand is a relatively good place to do business is of little consolation. This survey is motivated primarily by problems facing the developing world such as the paperwork involved in starting a business, access to credit, protecting investors and enforcing contracts. Most advanced countries have few serious problems under those headings. What the World Bank research does not address are the problems of government spending, tax and regulations, such as those identified by Roderick Deane, that are limiting New Zealand's growth prospects. And regardless of rankings, there is never a case for accepting poor quality regulation.

Businesses often talk about the costs of complying with regulations, but these are not the main source of regulatory cost. As Gary Banks, chairman of the Productivity Commission in Australia, has said:

> More damaging from a broader economic perspective can be the impacts on incentives for entrepreneurship and innovation, the distorting of decision-making away from the most productive avenues, or constraints on firm responsiveness to changing market conditions.[2]

The true costs of regulation are enormous. In the United States, for example, the costs of federal regulations were estimated to be $1.13 trillion in 2005. Given that federal government spending in 2005 was $2.47 trillion, the hidden tax of regulation now approaches half the size of federal spending.[3]

In an independent capacity, Gary Banks recently chaired a taskforce established by the Australian government to review regulation in that country in response to business concerns. The taskforce found that many

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[2] Gary Banks, 'Regulation-making in Australia: Is it broke? How do we fix it?', Australian National University, Canberra, 7 July 2005.

[3] Source: Clyde Wayne Crews, 'Ten Thousand Commandments: An Annual Snapshot of the Regulatory State', Competitive Enterprise Institute, June 28, 2006, http://www.cei.org/gencon/025,05407.cfm

of the concerns were justified and made 178 recommendations for reform, 158 of which have been accepted by the government in full or in part. The Productivity Commission has also been asked by the government to undertake a study on quantitative and qualitative indicators of the burden of regulation on business in Australia.

In response to a presentation by Gary Banks at a recent Business Roundtable seminar, minister of commerce Lianne Dalziel reiterated a comment she had made in a speech on the government's regulatory review. She said:

> If I could choose any Australian institution and have it transformed into a truly trans-Tasman institution, it would be the Productivity Commission.

That much is encouraging. However, while the Productivity Commission has often been asked to review existing and contentious regulatory policies in Australia, policy issues seem to be off-limits in our government's review. Big issues, like the basic shape of employment law, the Resource Management Act, reform of ACC and the regulation of network industries, are outside its terms of reference.

The government is aware that the review starts from a low base of credibility with business. Its own Small Business Advisory Group gave it a score of 5.3 out of 10 for its response to the group's first report. The government has rejected its most important recommendation, a 90-day probation period for new employees, at a time when the Australian government has scrapped so-called unfair dismissal laws altogether for small and medium-sized businesses and relaxed them for larger ones. Moreover, charging the Ministry of Economic Development to lead the review is hardly a good omen. The ministry has been responsible for many of the poor regulatory impact statements prepared in New Zealand, most recently the one on telecommunications unbundling.[4]

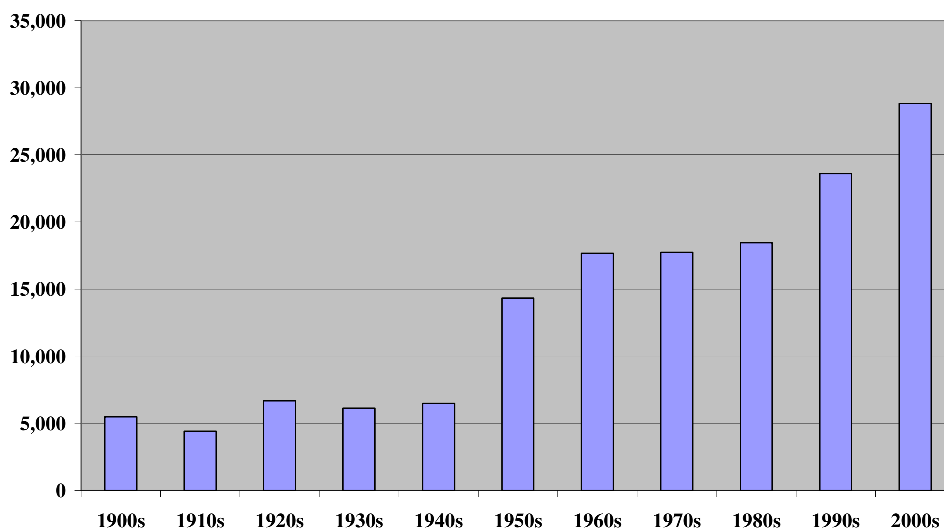
[4] A review of the quality of regulatory impact statements in New Zealand found numerous shortcomings: refer 'Regulatory Impact Statement Review', Tasman Economics, a report prepared for the Ministry of Economic Development and the Treasury, March 2001. To the best of my knowledge, the review has not been updated.

So, while welcoming the review, the business community will need convincing that the government is serious about it.

The regulatory juggernaut

The reality is that the amount of legislation that New Zealand businesses and households have to contend with has ballooned over the last two decades. The following graph shows the numbers of pages of new primary legislation (ie new Public, Private and Local Bills) passed each decade in New Zealand since 1900. Figures for the current decade are extrapolated from actual figures for 2000 to 2005. The data show that the number of pages of new primary legislation has increased dramatically over the last century. Moreover, the pace of growth has picked up markedly again after a period of deregulation in the 1980s and early 1990s.

Number of Pages of New Primary Legislation by Decade
1900s to 2000s



Source: Parliamentary Library

When secondary legislation is added in, the picture becomes even more disturbing. Figures from the Annual Report of the Parliamentary Counsel Office show that in the 2005 financial year, 9,327 pages of new regulations or Acts were published.[5] This was the highest number of pages of new

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5 Report of the Parliamentary Counsel Office for the year ended June 2005, http://www.pco.parliament.govt.nz/corporatefile/annualreport/2005/2005report.shtml#outputs

legislation ever published in New Zealand's history. The growth rate in the number of pages published has been a phenomenal 25 percent per annum over the last two years – seven times the rate of economic growth.

Where once the concern was regulatory creep, we are now seeing a veritable regulatory gallop.

Further, the Parliamentary Counsel Office figures don't include one of the growth areas of new regulations – so-called 'deemed' regulations and tertiary legislation. These regulations include Maritime Rules, Land Transport Rules, Gazetted Notices, Privacy Codes, Health Codes and numerous others regulations issuing from government agencies. As law Professor Michael Taggart noted in the Alexander Turner Chair Inaugural Lecture last year:

> The State has not retreated in any real sense since the 1980s, but rather has engaged with the private sector in very complicated patterns of interrelationship and interdependence, often in considerable tension. The rhetoric of deregulation, competition and privatisation deceived people into thinking there must be less, rather than more rules. This is not true. The resultant pattern of "mixed administration" has led to more delegated legislation, increased delegation of governmental functions to the private sector and more soft law …[6]

Is there any justification for this growing burden of regulation? Certainly the world has got more complex and more specialised. But as University of Chicago law professor Richard Epstein has noted, simple rules are generally the best way to deal with a complex world.[7]

Re-regulation: electricity

The electricity sector illustrates the trend towards re-regulation. The rot began with the decision by National minister of energy Max Bradford to require separation of lines and energy trading businesses. Subsequently, the Labour government established a sector-specific regulator, the Electricity Commission, with a flawed governance structure and multiple and often conflicting objectives. The government then became directly involved in decisions on new generation with New Zealand's two latest

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[6] 'The chequered history of delegated legislation in the 20th Century', University of Auckland, 26 October 2005.

[7] Richard Epstein, *Simple Rules for a Complex World*, Harvard University Press, Cambridge, Massachusetts, 1995.

power stations, Whirinaki and E3P.[8] Special legislation was also passed to cover water allocation and planning in the country's most important hydro-generation catchment, the Waitaki. The Commerce Commission has become a pervasive player in the sector. It now regulates the country's 28 electricity lines companies and Transpower under Part 4A of the Commerce Act. The companies have price and quality thresholds, with the price thresholds linked to the consumers price index. Transpower is now subject to Commerce Commission control of its prices and Electricity Commission control on grid upgrades, transmission service and quality standards.[9] The Commerce Commission has now shifted its attention to the electricity generators and is undertaking an investigation into their pricing behaviour.

Uncertainty around the government's climate change policies has also had a major impact on the sector. The government had proposed introducing a carbon tax from 2007 but it has since backed away from that decision. Now no one knows how the government plans to achieve its Kyoto obligations.

All this is having a major impact on investment decisions. Last month the government issued a policy statement aimed at encouraging infrastructure investment in the electricity sector.[10] However, two days later the Commerce Commission threatened New Zealand's largest private lines company, Vector, with price controls.[11] Vector's market capitalisation gained $250 million (10 percent) following the first government announcement and then lost $350 million (13 percent) following the second. Given these conflicting signals, it is hardly surprising that Vector subsequently put new investment on hold. As Bill Gallagher, CEO of Gallagher Group, has noted, "the real problem with electricity is that

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[8] In 2003, the government commissioned the construction of the 155 MW Whirinaki backup station. The next year, the government underwrote the supply of gas to the 385 MW gas fired power station, E3P, presently being built by Genesis Energy.

[9] In the latest moves, the minister of energy David Parker has foreshadowed in a recent Cabinet paper a move back to complete central planning by suggesting that the Cabinet could take decisions on grid upgrades. Such a move could spell the end of Transpower in its present form and the demise of the Electricity Commission.

[10] http://www.beehive.govt.nz/ViewDocument.aspx?DocumentID=26705

[11] www.comcom.govt.nz//MediaCentre/MediaReleases/200607/intentiontodeclarecontrolofvectorl_.aspx

business does not know what the government will do next."

Re-regulation: telecommunications

Regulatory gallop is evident in the telecommunications sector too. In May this year the government announced a package of regulatory measures including local loop unbundling; the uncoupling of local call access from digital services (so-called "naked DSL"); the enforcement of unfettered, unbundled bit-stream service; possible forms of separation of wholesale and retail operations; and further increases in the powers of the Telecommunications Commissioner (eg to undertake "strategic reviews" of the sector).

Other OECD countries have instituted unbundling but few have intervened on such a scale and the United States, in particular, is now moving in the opposite direction. Telecommunications Commissioner Douglas Webb undertook a cost-benefit analysis of local loop unbundling in 2004 and concluded that mandating it was not in the national interest. Officials did not even attempt a cost-benefit analysis when advising the government on its 2006 decision. If one were done, it is hard to see how the benefits could exceed the costs. Perhaps as much as $4 billion has been wiped off Telecom's market capitalisation, given that some expectation of intervention was already factored into Telecom's share price before the announcement. This loss in value is an approximation of producer surplus losses which would have to be matched by greater consumer surplus gains for the intervention to be in the public interest. With around 1.2 million households in New Zealand, each household would have to receive benefits (either directly or indirectly) of over $1,500 (in net present value terms) for the intervention to enhance economic welfare. This seems quite implausible.

The government's decision violates legitimate private property rights and reduces the wealth of tens of thousands of shareholders. If the measures could be shown to be in the public interest, the issue of whether they should be compensated for their losses should be addressed, but the government is showing no sign of doing so.

Re-regulation: other industries

The government has unleashed an avalanche of new regulations in other parts of the business sector as well. This includes the re-regulation of the labour market, promoting public access to private land, the Kiwisaver scheme (which adds to compliance costs and is unlikely to have any sustained effect on New Zealand's overall national savings rate), amendments to the Commerce Act, energy efficiency legislation, the application of whistleblower legislation to the private sector, gas information disclosure regulations, further banking and securities market regulation, and new regulations relating to building.

Recently the government announced its intention to extend subsidies to first-home buyers because of concerns that housing was becoming unaffordable. This is a further classic case of one misguided intervention being introduced to offset the effects of another. As a recent research paper highlighted, an underlying source of the problem is misconceived restrictions on the development of land.[12] New Zealand does not have a shortage of land. Only 1.4 percent of our land is urbanised. Mayors Sir Barry Curtis of Manukau and Bob Harvey of Waitakere are to be applauded for their recent statements that more land needs to be freed up urgently.

As well as the growth in regulation, we have seen five new government quangos created in the last six years: the Energy Efficiency and Conservation Authority, the Electricity Commission, the New Zealand Superannuation Fund, the New Zealand Venture Investment Fund and the Telecommunications Commissioner. There has been no equivalent reduction in quangos over the same period.

Other growth-reducing interventions

The increasing intrusion of government is not limited to greater regulation

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[12] Arthur Grimes and Andrew Aitken, 'Regional Housing Markets in New Zealand', a report prepared for the Centre for Housing Research, the Department of Building and Housing and Housing NZ Corporation, Motu Economic and Public Policy Research, March 2006.

and more regulatory institutions. Government spending as a share of the economy has increased by a full three percentage points of GDP – from 39 percent to 42 percent – in the last three years, according to the latest OECD figures. High levels of government spending (much of which is poor quality) and the taxation needed to finance it are a drag on the economy. Faster growth rates of the sort the government is targeting will be unachievable in this situation.

We are also, once again, seeing increasing ownership of commercial businesses by central government. Not only has the privatisation programme been stopped but it is being reversed with the government buying back majority control of Air New Zealand and the rail track, setting up a state-owned bank, and encouraging SOEs to diversify into new areas of business. This is sheer folly. The evidence demonstrates conclusively that SOEs, on average and over time, are not as efficient as private enterprises. The result will almost certainly be a lower growth rate going forward than would otherwise be the case.

Is it any wonder, in the light of all this, that business commentator Terry Hall concluded recently that “Kiwi companies and investors find the New Zealand government scary and unpredictable.”[13] Economic performance changes only with long lags. New Zealand’s economic reformers were criticised for years before their arguments were proved right in the 1990s. Similarly, the costs of policy backsliding take time to show up. But the growth in government spending, taxation and regulation since the late 1990s is now clearly taking its toll.

Ten years ago New Zealand had a regulatory environment that was lighter-handed than Australia’s. Whether that is still the case is highly questionable. According to the latest Heritage Foundation/*Wall Street Journal* Index of Economic Freedom, Australia and New Zealand are level pegging at 9th equal placing overall.[14] Recent OECD reports have commented more favourably on the quality of economic policy in Australia

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13 Terry Hall, ‘Sink or swim in face of regulation’, *Dominion Post*, August 14, 2006.
14 http://www.heritage.org/research/features/index/countries.cfm

than in New Zealand.

Regulatory reform

What can be done about this endless piling up of regulation? A sound framework of regulation is needed to facilitate business transactions and help achieve other economic, social and environmental goals. However, this does not necessarily call for statutory intervention. The alternative to statutory regulation is not no regulation but rather regulation by private law, including the common law. The common law is sometimes called judge-made law as it arises from rulings made by judges, not politicians. Typically it develops in incremental fashion and is respectful of precedent and business practices. The common law rules on property, contracts and torts governed commerce before the modern era. They continue to do so and could have broader application, for example by displacing much ill-conceived employment legislation. Statute law may be superior to common law in some situations (for example the common law may not be able to handle pollution from diffuse sources well) and inferior in others.

For the same reason the policy issue is not regulation or deregulation, but rather the best form of regulation. There are many steps that could be taken to improve the quality of regulation in New Zealand. One option for addressing the outstanding stock of legislation would be sunset clauses or review provisions. Another would be to include opt-out provisions in legislation. For example, in the area of securities market regulation, the Takeovers Code could be available to those who want it, but companies could be free to opt out if, say, a super-majority of shareholders agreed. The Takeovers Code would therefore operate as a standard form contract, permitting companies and shareholders to economise on transaction costs, but there would be no mandatory one-size-fits-all approach. A third option would be to undertake in-depth reviews of existing legislation to see if the statutes or regulations are achieving their stated objectives and whether the benefits they generate exceed the costs.

Many if not all the above measures could be integrated in a regulatory responsibility law that required proposed new regulations to be subjected to a rigorous test of net public benefit and a periodic assessment of existing regulations. It would also require compensation for regulatory takings. Such compensation has long been required in New Zealand for takings under the Public Works Act. The principle could be extended to cover other takings where new government measures impact on the value of private property. A compensation requirement would give the government a powerful incentive to evaluate carefully the true costs and benefits of regulatory policies before they are put in place.

The idea of a Regulatory Responsibility Act has been championed by a number of business organisations and the New Zealand Institute of Chartered Accountants, which has done excellent work on regulatory issues. The proposal now has some momentum with ACT MP Rodney Hide's member's bill having been balloted for a first reading.

Conclusions

Modern economic growth is determined primarily by the quality of a country's institutions and policies. Businesses will only prosper in countries with sound legal systems and high levels of economic freedom. Excessive regulation is retarding business expansion in both New Zealand and Australia. Our governments should strive independently and jointly for superior policies and, if successful in this task, the business environment in both countries will become aligned more closely.

Efforts in New Zealand to tame the regulatory beast have met with only very limited success. New legislation and regulation is growing at an astonishing pace. Much of it imposes costs on businesses. It restricts their ability to respond quickly to market opportunities and threats and reduces the potential for economic growth, higher living standards and wider personal freedoms. A greater attachment to constitutional principles and more respect for freedom of contract and security of property rights – that is, for the rule of law – is needed if regulatory excesses are to be reduced in a sustained way.

If we can surpass the efforts of other countries, the regulatory environment for business in New Zealand and Australia would be a source of competitive advantage, making our firms more competitive and attracting more foreign investment. We compete with each other and with other countries for international investment and for human capital. That competition is putting pressure on tax rates. Ultimately it is likely to act as a check on poor regulation. The key question for New Zealand is how far down the regulatory path we will go before we realise that we are killing the goose that has been laying the golden eggs.

Possibly the government's recently announced regulatory review signals a dawning awareness of this prospect. It is too early to tell. I am reminded of the joke about rowing being the perfect preparation for public life. Why? Because rowing allows you to face in one direction while travelling in another. As yet, there is little sign of alignment between the government's words and its deeds.