

Newmarket Rotary Club

Escaping Mediocrity

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ESCAPING MEDIOCRITY

Thank you for the opportunity to address you today on the subject of the New Zealand economy.

Late last week, the Prime Minister chaired a conference on enterprise policies. I believe the government is absolutely right in emphasising the need for a much more widespread enterprise culture in New Zealand. In the United States, the number one hero is the entrepreneur who succeeds. The number two hero is the entrepreneur who fails. We have to create that kind of enterprise ethic if New Zealand is to escape from its longstanding economic mediocrity.

Only business can efficiently mobilise resources to take advantage of international market opportunities. The recently released Porter study pointed to the improvements in economic and business strategies that are needed to meet the demands of the international market. New Zealand exports currently account for less than 1 percent of world trade. A small increase in market share can mean phenomenal growth for individual companies and for the economy generally.

It is an outcome we must strive for. New Zealand exports are presently only 28 percent of GDP. At least 20 other small and more outward-looking countries have higher export to GDP ratios.

We need to bear in mind the available opportunities in world trade to put in perspective the realities of barriers to market access for some of our exports. Despite attempts by some countries to restrict imports, international trade volumes grew 80 percent over the decade of the 1980s. There is a vast market out there to be tapped. We should be concentrating on international demand for our products, rather than on expedients to engineer demand at home. Almost invariably, these undermine our capacity to be internationally cost competitive, an essential prerequisite for success in world markets.

New Zealand can only improve in economic terms by expanding its efficient export and import substituting industries. The present need is to transfer resources away from the non-traded sector to those industries. It is not a sign of poor economic health in the short term that domestic consumption is weak and industries like retailing and house building are having a hard time of it. The real signs of better economic health will include improved profitability for industries such as farming, manufacturing and tourism, and higher rates of investment in them.

In the past New Zealand has not performed well in exporting. Why should we begin to do so now? Success in any market involves supplying goods that are in demand at the highest standards of quality and delivery and at a competitive price. Are we learning the lessons of success?

Well, there has recently been cause for hope in at least one important respect. The Employment Contracts Act allows employers and employees much greater freedom to agree on employment arrangements which will serve their mutual interests better and encourage more cost effective ways of creating a product or providing a service. In these times of heightened insecurity about jobs and company viability, both

workers and management can now seek employment conditions which focus on the key ingredients of competitiveness. In turn that will deliver employees the job security they understandably seek.

It is not surprising that the most recent World Competitiveness Report shows a close relationship between flexible labour markets and the quality and reliability of a country's products. Switzerland and Japan, countries with few restrictions on employment contracting, ranked highly in each category while New Zealand scored well down the table in both. Switzerland and Japan also took top honours for the readiness with which the labour force accepts the introduction of labour-saving technology and the productivity-related motivation of workers. New Zealand scored near the bottom for both factors.

The recent port reforms are a good example of the type of productivity gains achieved by even partial reforms of antiquated labour practices. Labour productivity has increased by more than 40 percent, turnaround times for ships have halved at almost every port and stevedoring charges have been reduced by between 20 and 50 percent. I have no doubt that further substantial gains will be achieved under the new employment legislation and the moves to privatise port companies.

It is not easy to overstate the damage caused by the fortress New Zealand economic management mentality and policies. As the recent Porter study commented:

"New Zealand management has for too long been trapped in a mindset that the modern global economy has rendered inoperative. It has yet to make the quantum jump necessary to meet and beat the world's best competitors... The 'Kiwilifestyle' and the low status accorded business have blunted our willingness to make sustained personal commitments necessary to achieve business success in a global economy... Part of rebuilding the competitive position of New Zealand will require fundamentally rethinking our goals as individuals..."

Productivity improvements are still hampered by obsolete plant and equipment, unsophisticated investment strategies, strong resistance to better labour practices, and gross inefficiency in central and local government.

Decades of import controls, occupational licensing, 'poverty trap' tax and welfare systems, monopoly unionism and widespread government ownership and intervention in industry have all worked against competition and fostered a 'make believe' culture divorced from the demands of the international marketplace. Foreign exchange controls effectively blocked joint ventures with overseas businesses and impeded rapid acquisition of technical and managerial skills. The 'cradle to grave' welfare system blunted incentives to work and save. Several generations of savings have been squandered in artificially protected industries, the cost-overruns of the 'think big' projects and the mid-1980s property boom.

We still have a long way to go to throw off this legacy. There is a pressing need for further decisive changes to restore balance to an economic programme which has foundered for the last three years. As a visiting Australian politician recently remarked, New Zealand has paid a terrible price for the way in which reforms were blocked after Prime Minister Lange lost his nerve and left the economy "rudderless in the stormy seas of a deepening recession". In particular, fiscal policy remained

largely in conflict with the stance of monetary policy. Hard won gains were abandoned in the 1990 budget, and the incoming government inherited an appalling fiscal outlook. Reducing the spending and tax burden by eliminating the widespread economic inefficiencies and inequities in existing government programmes is now the main imperative facing the government. It is not an enviable task but there are no soft options left.

Many New Zealanders do not seem to realise how far we still have to go to become competitive in economic terms. To listen to some commentators one might be forgiven for thinking that New Zealand had become a sort of economic freak that made Hongkong look like a planned economy. Nothing could be further from the truth. For example, the current programme for tariff reductions will still leave New Zealand with higher tariff rates at the end of the programme than the present OECD country average. There is still too little recognition of the fact that protection or assistance to one industry is effectively a tax on other industries. The OECD noted in its 1990 report on New Zealand that:

"... protection is concentrated on the same sectors as in most other OECD countries, probably neutralising the potential for employment protection, while locking resources into uncompetitive industries and imposing heavy deadweight costs on consumers."

The same comments could be made about other policies. No successful economy has New Zealand's extravagant state pension arrangements, a monopoly state accident insurer (with a no-fault liability regime for all accidents), a tertiary education system where students pay so little of the costs of tuition, or an export sector with controls over as wide a range of exports as those controlled by the producer boards.

The government has made a good start on the road to creating a better environment for enterprise, but it is only a start. Last December's package of welfare cuts and tighter eligibility rules is aimed at limiting disincentives to work and spurring more intensive efforts to find employment. There are already signs that it is having this effect and the new labour legislation will progressively make finding work easier.

However, these measures alone will not mean that economic growth will automatically take off and unemployment will quickly subside. All participants in the workplace will have to face the realities of meeting the challenges of the real world - the international markets. Too many employers and unions seem inclined to carry on with the old system, at least for a bit longer. I am doubtful whether the government has done enough yet to curb the Labour Court's propensity for economic sabotage which it has shown in redundancy and dismissal cases over the last couple of years or so. Minimum wage restrictions still apply at a level comparable to the United States, which has a far higher wage structure than New Zealand. In its report, the OECD noted that these needed to be changed if the government was serious about tackling unemployment. There is a strong case for reducing the statutory minimum wage and placing a limit on the time people may remain on the unemployment benefit.

Other moves are needed to improve the work ethic and upgrade the quality of our labour force, as noted in the Porter study. As a means of injecting new skills and attitudes into the domestic economy, immigration may have a significant role to play. Attracting people to New Zealand who want to work hard, who have language

skills, and who know the culture of other markets and can create links with them will be increasingly important.

Education also has a fundamental role in creating a prosperous future for New Zealanders. Limited consumer choice and government dominance of the delivery of education has meant that high standards have given way to an education bureaucracy demanding a curriculum biased against competition and business, emphasising equality rather than quality, and downgrading the role of accurate and objective measures of performance. Education Minister Lockwood Smith's efforts to tackle these problems deserve strong community support.

A broader and more consistent economic programme needs to be built on the promising start that the government has made. Business confidence is fragile after the previous government's reform programme was aborted in 1987. Governments trying to raise credibility from the ashes have to show even greater consistency of policies each time past reforms have been abandoned.

The National Party outlined its goals during last year's election campaign. They were:

- achieving at least 3 percent growth by the end of its first term
- halving unemployment levels
- inflation in the range of 0-2 percent
- single digit business and mortgage interest rates
- a balanced budget
- a reduced share of government expenditure and taxation as a percentage of GDP.

These are challenging commitments. The inflation and interest rate targets look to be within reach but others are not without major policy changes. Obviously, the government will be judged at the next election on how well its record compares with this set of commitments.

In the eyes of the business community the factor that is now absolutely critical to restoring business confidence and business activity is action by the government to get its own house in order. Successive governments have been trying (with varying levels of enthusiasm) to reduce or hold expenditure levels for two decades. Yet during that time government expenditure has risen from under 30 percent of GDP to over 40 percent and public debt has climbed to dangerous levels. Our politicians simply have to kick the habit of fiscal irresponsibility.

The fiscal picture for the next three years indicates that there is no room for adopting mediocre policies or allowing strong policy plans to drift away from their initial purpose. Inadequate action in the forthcoming budget would destroy in one blow the credibility so far earned. Declining interest rate trends would be reversed and business confidence would be in danger of collapsing further.

Simple fiscal arithmetic indicates that most of the necessary decisions lie in the social policy area. Only consistent, principled and far-reaching reform of superannuation, housing, health and education policies will demonstrate that the government is absolutely committed to pursuing policies for the good of the community rather than the appeasement of special interest groups. Enormous courage and conviction will be required simply because of the comprehensiveness and complexity of the reforms

that are now essential. They will take time to implement and have full effect, and politicians will be vulnerable to another round of claims that people's lives and welfare are being put at risk. The reality is that failure to grasp the nettle will jeopardise the capacity of the economy to sustain any meaningful welfare system whatsoever in the longer run.

I think most New Zealanders appreciate the seriousness of our current economic situation. Even popular magazines like *North and South* are now carrying quality features on the economic destruction that has resulted from out-of-control welfare policies. An excellent piece of journalism in the May issue made the following points:

- * More than 30,000 liable parents, mostly fathers, owe the Social Welfare Department \$400 million towards the cost of the domestic purposes benefit for their former spouses and children. Only 40 percent of liable parent contributions are collected, and these cover only 8 percent of the DPB's cost.
- * Welfare payments this financial year will cost \$25 million more than the government expects to collect in PAYE income tax. Only 1.2 million New Zealanders still have full-time jobs - just 80,000 more than the number living full time on welfare benefits, including the pension.
- * National superannuation, or 'guaranteed retirement income' as Labour renamed it, will cost \$5.1 billion this year, twice as much as the dole and the DPB combined and more than is spent on either health or education.
- * A quarter of all children are now raised in single-parent homes, including half of all Maori children. The number of sole parents paid the DPB doubled between 1975 and 1980 and doubled again by 1987. It has risen more than another third since.
- * Until the 1 April benefit cuts, the dole for a married man with two children was higher than the wages paid under at least 29 awards. Even with the recent cuts the dole is still 74 percent of the average wage.

It is hard to overstate the importance of the government formulating clear goals, developing a consistent framework for the design of individual policy initiatives, setting legislative timetables and fiscal targets, and selecting people with the commitment and ability to implement radical changes. To avoid the fate of the botched Picot reforms in education, close attention to detail and timing will be needed to minimise the risks of essential reform programmes being derailed.

A theme of all policies in the social services field should be to open as many areas of government provision as possible to competition, to create a quality environment of individual or family responsibility, and to target assistance to those who really are in genuine need. On this basis, I believe there are a number of key criteria for judging the forthcoming budget:

- * Bold decisions on benefit and eligibility criteria for superannuation need to be made. Benefits should be set at levels designed to provide a basic safety net, universal provision must be replaced by a targeted scheme and the age of eligibility should be lifted to somewhere in the 65+ age range. The transition

to the new arrangements should be as short as possible. Superannuation is the single largest area of government spending. Failure to tackle this issue would simply require much harsher decisions in housing, health and education.

- * The second area where substantial fiscal savings can be made while improving the quality and responsiveness of services is health. A first step would involve the corporatisation of public hospitals to achieve the efficiency gains identified by the Gibbs Task Force, which were sadly ignored by past Ministers of Health. There is then a good case for shifting the financing role to competing private insurers, subject to a minimum level of coverage and with targeted assistance to people on low incomes or with high health costs. Any reasonably informed observer can see that the present health system is on the verge of collapse and major structural changes are needed.
- * In the education sector there are strong arguments for increasing rather than reducing tertiary fees. Tertiary students benefit from higher lifetime earnings and so-called 'free' tertiary education is overall a massive transfer from poorer to better-off groups. To their credit, the polytechnics have taken a lead in the debate by recognising the need for greater productivity in individual institutions, canvassing extensions to the academic year and teaching day, and advocating higher student payments. They should be applauded for their stand and the universities would do well to support similar moves instead of pandering to student unions.
- * At the school level, moves to bulk funding of teacher salaries would get the process of creating autonomous and self-managing schools responding to consumer choice back on track. The problems in education will not be solved by throwing money at them. Education spending grew by 29 percent in real terms between 1985 and 1989 with little apparent effect on education outcomes. Structural changes and competition within and between the public and private education systems must be the way forward.
- * Targeting strategies need to be applied much more broadly. Electorates world-wide are coming to realise that there is little point in recycling large slices of middle and upper income earners' tax revenues through the fiscal system to spend on goods and services which they could purchase themselves if taxes were lower. The culture of the Department of Social Welfare, in particular, must be changed. As *North and South* pointed out, it has become a constituency for spending increasing amounts of taxpayers' money without regard to the nation's economic crisis or the effect on those on benefits.
- * The SOE/privatisation programme must be given a fresh impetus. Markets will be looking for concrete decisions on the major outstanding state business sales, particularly the Electricity Corporation and the Housing Corporation.
- * There must be fresh initiatives to hold local bodies to account for the quality and quantity of their expenditures, and to encourage if not require them to privatise their commercial activities and contract out other functions to private enterprise. Too few local authorities have yet recognised that they have no comparative advantage in running commercial ventures and that they should not be exposing ratepayers to business risk.

- * The three year fiscal projections are important for focusing attention on the sustainability of government policies. Assessing the true fiscal implications of budgets is difficult at the best of times. The practice in New Zealand typically involves hiding contingency claims, delaying expenditure (particularly on maintenance items), bringing forward revenue items, hijacking SOE dividends and counting one-off capital items (such as forestry cutting rights) above the line. Nowadays such creative accounting is rapidly exposed by analysts here and abroad and the credibility of ministers of finance can only suffer.
- * The government should re-commit itself to tax reductions by the end of its term, and remove those taxes such as withholding tax on non-resident incomes that effectively penalise economic efficiency to a high degree.

A budget which broke the mould in New Zealand in this way would give us a real chance of escaping from mediocrity and enjoying the benefits of an enterprise economy. It would give a substantial boost to the tentative signs of an improved outlook that have recently been emerging. The economy is currently showing bottom of the cycle behaviour but the period ahead will remain difficult. However, slow is best, as only attention to the fundamentals, not a dose of economic steroids, is going to get us into competitive shape for the longer haul.

Businesses will respond to an improved policy environment if they have confidence in it. But business decision makers are rational about both political and economic factors. It was idle for David Caygill to lament in early 1989 that he had inherited an efficient economic vehicle which was unaccountably stalled at the traffic lights. Businesses did not "get on with the job" for what turned out to be totally justified reasons. They remained cautious and defensive; they would have been negligent to their shareholders to have behaved otherwise. Confidence can only be earned by solid, integrated, sustained policy decisions. 'Trust me' statements, especially from politicians, will not get New Zealanders saving and investing for economic growth.

In other countries restructuring took up to ten years to produce benefits in the form of strong growth in profits and investment and sustained output expansion. New Zealand is only a few years into the process and regrettably there have been some serious mistakes, including stopping for cups of tea. The current government now has the opportunity, and probably only one opportunity at that, to chart a new course. If it fails, a fall to a Third World credit rating, and sooner rather than later, would be a near certainty.

At that point, ladies and gentlemen, the Argentinians will be entitled to cry for us.