

**New Zealand Institute of Valuers  
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**Achieving a Positive Economic Direction**

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## **ACHIEVING A POSITIVE ECONOMIC DIRECTION**

A few years ago, on a routine visit to a Soviet collective farm, a Russian commissar demanded of one of the workers in the fields: "How was the crop this year?"

"Oh, we had a fantastic harvest," was the reply. "Many, many potatoes. So many potatoes, in fact, that if you piled them up in the sky, they would reach the foot of God!"

The commissar scolded, "There is no God, comrade."

The worker retorted, "There aren't any potatoes either."

For over 70 years, the Soviet people lived this sort of double-edged lie. But they did not have the capacity for self-deception to themselves. For much of the same period New Zealand lived in a make-believe economic environment and avoided confronting reality. In a smaller way, we have been going through the agonising transition that the ex-Soviet Union is now trying to implement.

The lessons of the economic carnage and human distress caused by poor forms of social organisation are hard for many people to accept. Doctrines such as "from each according to his ability; to each according to his needs" have a seductive appeal. The same mistakes have been repeated down the centuries.

I experienced this lesson at first hand a couple of years ago on a visit to Czechoslovakia. I went there to learn something about the economic and social experiment in that country over the last forty years, and the problems it faced in moving to a market economy.

I visited the little town of Tabor, an hour or two's drive south of Prague. In the Hussite era, early in the 15th century, congregations of the poor assembled in the hills and Huss, along with other preachers, taught the doctrine of social equality. They banded together and founded the town of Tabor.

As the guide book tells the story, vats were set up in the square, into which the people threw their money and valuables, the famous Tabor Treasury. This was the first attempt at a communisation of property. The Tabor revolutionary Articles proclaimed it quite clearly: "Nothing mine and nothing thine, but everything equally in common ... all will be equal brothers and sisters." Unfortunately quarrels upset the unity of the revolutionary movement. The poor who joined the fighting expeditions were gradually stripped of their power by the petty bourgeoisie, the small tradespeople and the squires, who attached themselves to the movement only in the hope of getting rich on the booty.

The guide book concludes:

"Many events in the recent history of Czechoslovakia would be more understandable for foreigners if they were better acquainted with this Hussite period of Czech history."

This story could serve as a parable for countless other well-intentioned but ultimately disastrous social experiments. It is certainly not the last attempt at redistribution

towards the poor to be captured by the better off. Its lessons have been learned, at least for the time being, in Czechoslovakia. As Vaclav Klaus, the Czech finance minister and one of the leading figures in Eastern Europe, put it last year:

"We need an unconstrained, unrestricted, full-fledged, unspoiled market economy, and we need it now."

We still hear claims that New Zealand's efforts to open up the economy and limit the role played by the government are policies that have "failed" and been "discredited" elsewhere in the world. It is hard to understand why newspapers bother to print such rubbish. As the London magazine *The Economist* recently wrote:

"During the past ten years a great change has swept through the developing world: governments everywhere are turning against economic interventionism and putting their trust in market forces. In many countries, traditional thinking on development had led governments to involve themselves so deeply in economic management that years of reform will be needed to roll back the state. But there can be no doubt that the effort to do this is under way. In Latin America, Africa, South Asia and Eastern Europe - regions where interventionist methods were taken to their most ambitious extreme - it is governments themselves, not outside observers or advisers, that are most outspoken in their denunciations of the old ways."

In Latin America, virtually every significant economy has reduced barriers to trade and investment, lowered inflation and embarked on programmes of deregulation and privatisation. Governments of all political labels - leftists and populists included - are following fundamentally the same economic script. Belt tightening has meant short-term pain, but investment is up, stock markets are booming and economies have begun - tentatively - to grow.

A leading Indian businessman on a recent visit urged New Zealanders not to overlook India when looking for business in Asia. He reported that over the past nine months the Indian economy had undergone radical deregulation, loosened the bureaucracy, simplified tax and banking laws and reduced tariff barriers. He said the changes had the support of all three main political parties and although opinion differed over the rate of change, there was no disagreement about its direction.

Five years ago, dictatorships proclaiming socialist theories prevailed in Africa. Even in the dark continent steps are now being taken towards structural reforms which, according to the Managing Director of the IMF, are "as far reaching as anything that is being undertaken in Eastern Europe or Latin America." Africa's agenda of 'things to do', as listed by *The Economist*, is indeed daunting:

"... balance the budget; make the docks, airports and public utilities work; close corrupt (and bankrupt) state banks and encourage private ones; privatise state enterprises; get rid of needless controls and licences; make the currency competitive; liberalise markets and labour laws; make it easy to set up a company; encourage the "informal sector"; go for export-led growth; don't treat investors, domestic or foreign, as predators, but allies, and go out and woo them."

Similar reform programmes are being implemented in more wealthy countries whose economies stagnated under the weight of state domination and burdensome welfare

policies. Most notable of these is Sweden, a 'third way' icon for social democratic politicians for many years. Sweden is now adopting the market-based policies of the rest of the West. On his election last year, the new conservative prime minister, Mr Carl Bildt, declared: "The age of collectivism is at an end now". About 55 percent of the Swedish population had become in some way dependent on the state for assistance. "We were trained to be helpless," one Swede was quoted as saying in a recent *Australian Financial Review* article. The article went on:

"The social democratic rhetoric about solidarity and equality has vanished with Mr Bildt's election, replaced by calls from his ministers and supporters in the business community for private enterprise, the profit motive and competition."

Of course, not all of these changes in direction will succeed. There will be interruptions, relapses, mistakes and sheer bad luck in carrying reform programmes through.

Moreover, around the world there are exceptions to the trend. The United Kingdom seems to have reverted to pre-1980s politics: the recent election was described by one commentator as a contest between fumble and bumble. In Australia, the politics of the pork barrel appear to be back in the ascendancy. Some New Zealand observers see these shifts as welcome signs of "pragmatism" and "realism". Others see them as sad developments for the two countries which, after New Zealand, have been the OECD's worst performers in the post-war period.

The media in this country could do a better job in helping the community to understand that the New Zealand reforms of recent years are wholly in line with worldwide thinking instead of reporting the claptrap about "failed", "monetarist", "New Right" policies.

One of the prime influences on the New Zealand reform programme was the economic policy consensus within the OECD and its member governments over the past 10 years. On his recent visit, the OECD secretary general, Jean-Claude Paye, gave the thumbs up to the programme, noting that New Zealand had done more than most of the OECD countries and faster than most.

Monsieur Paye also put his finger on one of the important lessons of New Zealand's experience:

"You have to move on a broad front. You can't select one or two domains for reform. Reform should not be limited to economic matters, but should include social areas, like the labour market, health and education... The government has now entered into those areas which in our view in Paris were lacking in terms of reform."

The first key reason why the benefits of the reform programme have been slow to emerge, and why many people have not been convinced of its merits, is that until recently it has been partial and inconsistent. As the Book of Common Prayer would have it:

"We have left undone those things which we ought to have done, and we have done those things which we ought not to have done."

Not surprisingly, economic salvation has eluded us. The things left undone by the previous government were essentially the labour and social welfare reforms, and the failure to check and reverse the upward spiral of government spending and taxation. The main thing we ought not to have done was stop for a cup of tea in the middle of an incomplete programme. Together these errors greatly compounded the adjustment costs faced by businesses, the unemployment problem and social hardship.

The second key reason why the going has remained tough is simply that transforming a distorted and debt-ridden economy, and a society accustomed to state dependence rather than self-reliance, is a long-run task. As a recent report prepared for the Atlantic Council of the United States noted:

"New Zealand has largely accomplished successful reform over the past 7 years, while West Germany took about 10 years for its reforms in the late 1940s and the 1950s. Spain took 15 years, with most of its accomplishments in the last 7. Chile's reforms took 18 years, partially because of mistakes in the early years and recessions in the mid-1970s and the early 1980s. Taiwan and South Korea, often held up as models for other reforming economies, have moved gradually, spending the past 40 years in the effort in the case of Taiwan, and 25 in the case of South Korea."

I believe that statement under-estimates the work that still needs to be done in New Zealand to achieve a successful economic transition. In respect of policy reforms, we are far from being out in front. For example, halfway through its term the government will have achieved little by way of privatisation of state businesses. By comparison Chile, under a centre-left government, has begun to privatise government-owned hospitals. The rest of the world is not waiting for us to catch up.

Nonetheless we can have a high degree of confidence from worldwide experience that the policy programme now in place will produce a much improved economic outlook. OECD countries which brought their inflation rates down in the 1980s were rewarded with a better growth performance. Following structural reforms and a period of recession, investment picked up strongly. The same mechanisms which led to these results are at work in our economy.

The gains in efficiency and productivity that have been achieved in recent years are substantial. Unit labour costs in the business sector grew by 1.7 percent in 1988 compared with 7.4 percent in Australia, by zero in 1989 compared with 8.5 percent and by 1.4 percent in 1990 compared with 8.1 percent. The cumulative improvement in competitiveness vis-a-vis Australia in those 3 years exceeded 20 percent. The productivity improvements flowing from the Employment Contracts Act are adding to those gains.

We know from our business cycle history that when New Zealand has achieved a competitive edge - usually temporarily in the past - the recovery can be quite strong. This time the gains look sustainable, and are occurring at the bottom of a terms of trade cycle. A slow upturn appears to be underway in the world economy, with the IMF predicting growth of 3.25 percent in the industrial countries next year. New Zealand is well positioned to take advantage of it.

The major short-term threat to a sustained recovery is the government's fiscal position. The seriousness of the fiscal problem has been consistently under-estimated

over the last several years. There is still a need for major policy changes to achieve financial surpluses and retire debt. If pursued, these will allow monetary policy to remain broadly neutral and benefit internationally competing industries, but will limit any short-term expansion of domestic consumption.

We have to be mindful that more than one apparent or real recovery in recent years has withered on the vine because of a loss of policy momentum and political drift. The problems of the economy are deep-seated, and there is a need for realistic expectations about how quickly things can improve.

In the period ahead the nation, the corporate sector, farmers and many households will have to devote much of the expected increase in income to paying off debt. For the time being we must allow an expansion in activity to be taken up by reductions in the pool of unemployed rather than reflected in higher wages for those already in jobs. All this will demand patience and understanding, and for a considerable time.

With the skies clearing and the sun coming out, we must make hay while it shines. There is no longer any excuse, for example, for not reducing the budget deficit on the grounds that the economy is in recession. This argument was always weak but those who advanced it should now, if they are honest, be calling on the government to step up the pace of fiscal consolidation. Incidentally their folk hero, Lord Keynes, advised Australia to reduce its budget deficit and cut tariffs in 1932 when the unemployment rate was 30 percent. As surely as night follows day, New Zealand will encounter another international recession or external shock in the 1990s. We must reduce our vulnerability and achieve a more robust position before it hits us.

Whether governments stay the course of a reform programme or not is much less a matter of the strength or frailties of individual politicians as it is of the state of public understanding of what makes an economy work. Changing governments in today's world often changes relatively little: the realities of debt, credit ratings, internationally mobile capital (and increasingly labour) and international competition do not go away. Unless they are bent on economic sabotage, governments are tightly constrained in the choices they can make.

I believe there is a much improved understanding of these economic realities among the general public, in New Zealand workforces, in the financial sector and in business and farming organisations. Only a few years ago a topical joke went: "Why are past-presidents of the Manufacturers Federation buried only 3 feet deep?" Answer: "So they can still get their hands out for the next hand-out." With few exceptions that mentality has gone, including in the Manufacturers Federation. The priorities for all business organisations are now things like lower government spending and taxes, more efficient local government, better education and low cost commercial laws.

I am less sure about some economic commentators. BERL, for example, recently achieved the incredible feat of modifying its forecast for economic growth for this year and next by no less than 4 percentage points within a three month period. Plainly it was scrambling to retrieve itself from its position of pathological economic pessimism, but its attempts to interpret the current economic situation looked as though they came from a random word generator. And, regrettably, the contributions of academic economists too often do not measure up to those of their counterparts elsewhere. In the judgment of Paddy McGuinness, the respected Australian economic commentator, the majority of academic economists in New

Zealand are, for the most part, the rejects of British or Australian universities, while those of high quality in the Treasury and Reserve Bank are generally unable to speak out.

Beyond those groups, we clearly have a long way to go in institutions such as the education sector, the church, the trade unions and the media to develop the kind of consensus for sound policy which sustains governments in, say, the successful Asian economies. No doubt opinions will change as the climate of ideas around the world continues to evolve, and as the benefits of reform take hold in New Zealand. Nothing succeeds like success. But in the short term, the lack of understanding remains a threat both to policies and to politicians brave enough to stick their necks out in support of reform.

If we are to continue moving forward, New Zealanders concerned about the future of the country must be prepared to debate the issues soberly and dispassionately, even in the face of misrepresentation and abuse. Pointing out realities, and standing up and being counted, is not always a popular vocation. But in the long run, Keynes was surely right on one point: ideas count, and they do prevail over vested interests. The responsibility to take part in the debate lies with all of us.