

***The Economist's Fifth Roundtable With The
Government Of Australia***

**Australia And New Zealand - A New Economic
Partnership?**

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As an Australasian businessman, I'm honoured to have made it on to your conference programme along with so many distinguished ministers, politicians, regulators and union officials. It's good to see the private sector was not entirely overlooked in a symposium on Australia's future.

My task is to look at today's economic partnership between Australia and New Zealand. I need hardly say that both countries have come a long way since the Closer Economic Relations agreement came into force in 1983. Both countries started with insular and over-regulated economies. Both were becoming increasingly embarrassed by international comparisons, having once been among the wealthiest in the world. We were by no means equally delinquent: Australia had merely become a slow learner in OECD terms, while New Zealand was the class dunce. Many people in this country saw New Zealand as a millstone around Australia's neck.

Early on in the CER process it was New Zealand that was more often the reluctant partner, unsure about its ability to compete and pleading for special treatment. More recently, New Zealand has been the country wanting to force the pace of integration, while the Keating government was mostly holding back. Fifteen years ago, manufacturing industry in New Zealand could not contemplate the idea of dismantling import licensing against Australia by 1995. Several years ago licensing disappeared against all countries, tariffs are now at similar levels to Australia and there is little resistance to the idea that we should press on to full free trade.

These days there is broad agreement that CER has proved valuable to both sides. The framework is largely complete, but there is still work to be done to remove all remaining restrictions and create a single market for business.

In this context, there has been a new impetus since the change of government in Australia. This has been warmly welcomed in New Zealand. Real progress has been made towards establishing a single aviation market; remaining tasks include agreements on passenger clearance and beyond rights. The protectionist trans-Tasman maritime union accord has cost industries and consumers in both countries dearly, and the recent BHP initiative, backed by the clear stance of the Federal government, is, I hope, the beginning of the end of this anachronism.

There is still work to be done on investment, as ministers have recently agreed. Our countries are so closely bound together - with a common labour market, for example - that it surely makes no sense to require regulatory approvals on capital movements. These involve costs, delays and political risk. New Zealand is now massively more outward-looking - more so I believe than Australia - and most people understand the benefits of foreign investment. Despite some continuing political debate, I can't see New Zealand changing course, and freeing trans-Tasman investment would be a small step in the right direction for Australia.

In the international competition to attract inbound investment, tax regimes matter. On the other side of the coin, the tax treatment of Australasian companies should not artificially restrict their development as global businesses. The international tax

regimes of both countries are not ideal, and there is work to be done to improve them in both a trans-Tasman context and a broader one.

There are other issues on the list of outstanding CER business such as closer integration of our sharemarkets, standards, quarantine matters and so forth - and, I would like to think, restoring passport-free travel between the two countries one of these days. We would do better to concentrate on such practical matters rather than on ideas like political integration which seem to have sidetracked the European Union project.

But the whole purpose of CER was to help each country break out of its cocoon and tackle the wider world. Competition forces industries to become more efficient: the idea was that if we couldn't cope with competition between ourselves, we'd be in poor shape to compete with the world's best performers. That is by far the greater challenge confronting us today if we aspire to the living standards of the top rank of countries.

Writing in *The Spectator* recently, British historian Paul Johnson suggested the fundamental shifts which have been taking place around the world have revolved around three main discoveries:

First, that socialism not only does not work but leads directly to poverty. Second, that it is a mistake to use the state to try to redistribute income - to tax the successful in order to subsidise the unsuccessful. Third, that allowing producer interests to dictate economic policy is a formula for long-term decline.

Johnson argued that politicians like Blair and Clinton might well carry moves such as the removal of union privileges, privatisation and the shrinking of big government well beyond the point reached by Thatcher and Reagan.

Since New Zealand drew back from the economic brink in 1984, it has applied some of these discoveries with vigour and transformed its economic fortunes. It has been frustrating to watch Australia dragging the chain for much of this period. Our financial market deregulation was virtually complete in 1985, for example, whereas the Wallis inquiry is now considering the next steps here. The decision on the New Zealand goods and services tax was taken the same year. It was introduced in 1987 and controversy over it has long since disappeared, yet it is still not on the political agenda on this side of the Tasman. The telecommunications industry in New Zealand was fully deregulated and privatised in 1990: will Australia get there this century? To be fair, and to mention an industry in which I have an interest, price surveillance of beer in Australia has just been scrapped, so Australia may be catching up to the New Zealand of the 1970s and early 1980s.

In my view, the biggest policy imperative facing Australia today, and the area where the biggest gap has opened up, is labour market reform. It is hard to exaggerate the difference our Employment Contracts Act 1991 (ECA) has made to the New Zealand economy in just five years. The confrontational, strike-prone, inflexible industrial relations regime which we once shared with Australia - feeding off each others' bad ideas - has been replaced by a system in which workers and management are working to a common goal. Industrial unrest is down sharply. Productivity has been boosted

and unemployment has fallen. Workers have not been 'exploited', as opponents of the ECA claimed; some 85 percent say they are happy with their employment contracts. Real wages on average did not fall, and more recently wages in various skill categories have been moving up as the labour market has tightened. All this from legislation which was widely predicted to lead to a new industrial dark age.

Today we should share good ideas, and the lesson for Australia is that there are massive benefits from moving to a regime of full freedom of contract in the labour market. This should involve the abolition of all specialist institutions. The retention of a specialist employment court in New Zealand was a mistake: well-meaning but wrongly targeted attempts by our judges to 'help the worker' have cost workers dearly in lost jobs and wages. We are also suffering from archaic arrangements including national awards in parts of the public sector such as education, where the problems are a dominant government employer and a lack of competition. Needless to say, this sector has been characterised by old-style industrial disruption and union politicking this election year. Australia's workplace reform bill must be regarded as only a first step in overhauling your dysfunctional labour market.

Fortunately, in Victoria four years ago and in March this year at the Federal level, the Australian electorate seemed to hear the wake-up call. Moves are afoot to close the economic reform gap with New Zealand in many of the areas I have mentioned. Together the National Commission of Audit, the Productivity Commission with its stocktake of progress in microeconomic reform, and the Wallis inquiry will provide a platform for significant progress provided their recommendations are taken up. There are signs of interest in the adoption of frameworks such as New Zealand's Fiscal Responsibility Act 1994 and Reserve Bank of New Zealand Act 1989, but there is a tendency to favour watered-down versions of what have proved to be valuable disciplines on macroeconomic decision making. My view is that fortune is not on the side of faint-hearted and protracted reform efforts.

Moreover, New Zealanders need to recognise that not only are you closing the gap, albeit belatedly, on our reform agenda but in some areas you are overtaking us or are already well ahead. You have made good progress in the last 10 years towards dismantling your statutory marketing authorities whereas producer board reform in New Zealand has been slow and tentative. Australia is in the lead in the privatisation and commercial operation of electricity and water - industries that are still regarded as somehow 'special' in New Zealand. We are behind you in plans to sell airports. Your education system is ranked well above New Zealand's for meeting the needs of a competitive economy, and your welfare system is less expensive and less conducive to dependency than New Zealand's, although much needs to be done in both areas in both countries. It was pleasing to see the Productivity Commission arguing the case for more market-oriented approaches in both health and education.

But for both our countries the reality today is this: neither is the proper benchmark for the other. Singapore and Hong Kong have joined Japan in outstripping us in per capita income terms. Many other countries are moving fast to modernise their economies. Their industries will put intense pressure on ours if we fail to adjust and raise our productivity levels. The top performers are not burdened with high taxes, high levels of welfare dependency and inflexible labour markets. We are lucky to be on the periphery of one of the world's most dynamic regions, but we will only benefit if we engage fully with it. Political leaders have the duty to explain to the community

that the world is continuing to change and does not treat kindly those who fail to change with it. It is pointless to talk of reform fatigue if our citizens want to share in the spectacular rise in living standards that many more countries in our region look set to achieve in the next 15-20 years. Ironically, such talk often comes from people who are in institutions - such as universities - that have not even been reformed *once*, let alone repeatedly.

There are plenty of examples of countries becoming complacent and soft after going through a testing and liberating experience. Post-war Britain was an example. With the war safely won, the British forgot that progress is a constant struggle and preferred to put their feet up and enjoy the victory. They built a large and unsupportable welfare state, gave their unions *de facto* control of the economy, dumbed down their education system, and generally took soft options at every turn. Almost before they knew it, their former adversaries were richer than they were. Until Mrs Thatcher came along, many in Britain had come to regard the war years as an aberration, after which their normal habits of complacency reasserted themselves.

Business leaders and business organisations in Australia should be stressing the urgency of change more strongly than they have hitherto. Ultimately business has the responsibility to make the case to the community for the open, competitive, outward-looking economy: if it doesn't, no one else will succeed in doing so. Politicians can't be expected to get out in front on economic reform unless they have strong business backing. In the past, New Zealand businesses lobbied for short-term and self-interested policies and they reaped the consequences: a third-rate economy. Too many Australian business lobbies are still in that mode. Since 1984 more in New Zealand have been prepared to take a longer-term and national interest perspective, based on the belief that only what is good for New Zealand is good for business in the long run. That has been an important factor in maintaining a constituency for reform.

At the moment, the rest of the world regards New Zealand as just drifting at a time of dynamic change elsewhere - which means we are losing ground again. Political uncertainty is once again clouding our outlook. There has already been a significant cost: interest rates on 10-year government bonds in New Zealand are around 8 percent, some 20 basis points higher than Australian rates. A year ago our rates were over 100 basis points lower. That is a measure of how much riskier a country we have become, and how much ground Australia has made up.

New Zealand faces a set of choices at this weekend's election - the first under our new electoral system. One possible outcome is that we will embrace the challenges and opportunities of the dynamic Asia-Pacific region, and build on our recent success, stimulated by an Australia that will hopefully stay on the move. Another is that we will decide it is all too hard, opt for the quiet life again, and fritter away the hard-won gains. Few politicians are setting out an ambitious vision of what New Zealand could achieve if it put its mind to it.

As a businessman, it's possible to be relaxed about the result. If the electorate's verdict is that it doesn't want a business-friendly environment in New Zealand, companies will obviously respect that verdict and direct their efforts elsewhere. As a fourth generation New Zealander, I think that outcome would be a tragedy. The penalties would come thick and fast as the world lost interest in New Zealand, our improving social trends would sharply deteriorate again, and Australia could forget about New

Zealand as a dynamic economic partner. But if we have to learn the lessons a second time round, so be it. The good aspect is that the electorate has had the chance to see the gains from adopting sound policies, and will remember them if things go sour.

The same analysis applies to Australia. It has been scoring below New Zealand in international rankings of competitiveness and its credit rating is now also lower. Australia needs to become much more competitive and business-friendly. International businesses are only attracted on a large scale by competitive environments, not by artificial inducements like subsidies and tax breaks. Indeed if they have any sense they should be wary of such 'favours' by governments as they seldom last. Instead you should concentrate on getting your economic fundamentals right and removing the constraints: becoming competitive means learning to compete. As *The Australian Financial Review* put it last week, "no pressure, no progress". That is the only strategy that will allow Australia to achieve its enormous potential.

The political lessons for Australia and New Zealand have been clear for 20 years. The Fraser government had the mandate and the opportunity to set Australia on the right course but blew it. The Muldoon government in New Zealand opted for timid gradualism and let serious economic problems become chronic. Their successors embarked on bolder programmes of reform but at different stages lost direction and momentum. Only when our governments, backed by well-informed electorates, show the strength and stamina to accept discipline and continuous change for the long haul will Australia and New Zealand rejoin the ranks of the top performers.