

National Party Papakura Electorate

**Business And Politics:
Myth And Reality**

**Roger Kerr
EXECUTIVE DIRECTOR
NEW ZEALAND BUSINESS ROUNDTABLE**

**PAPAKURA
2 AUGUST 1996**

BUSINESS AND POLITICS : MYTH AND REALITY

It is a fact of life that in each generation the market economy has to be defended from critics. Misperceptions of business, and open hostility to markets on the part of many intellectuals, have been with us from time immemorial. That is paradoxical, since free markets and capitalist endeavour have a quite unparalleled historical record of success. The 200 years since the start of the industrial revolution have seen a period of material progress unique in history. As a result, the circumstances of low-skilled workers today compared with their counterparts in the late eighteenth century would strike the latter as quite literally unbelievable.

In the context of human history, this has been a remarkable transformation. A period of 10,000 years separated the discovery of agriculture and the next huge step forward into an industrial economy. While civilisations rose and fell over this time, material advancement was extremely slow. Stagnation was the norm, and the concept of a generalised forward advance for society was not even part of our forebears' psychological make-up. For all the richness of their culture, the ancient Greeks did not have a word that meant 'progress'. When the industrial revolution finally started in England, in the late eighteenth century, the time and place were propitious. The scientific revolution of the previous century had shown that the natural world could be progressively understood by the use of reason. That new scientific spirit came together with a collection of social factors that only eighteenth century England provided: the rule of law, political stability, broadly laissez-faire economic policies, and a culture of tolerance and openness to innovation. England provided the crucial market environment for a successful industrial economy.

Right at the beginning of this process, Adam Smith wrote his classic work, *The Wealth of Nations*, setting out many of the key principles governing the market economy. Smith correctly saw that the pursuit of profit by businesspeople was an enormously beneficial force for the wider good of society. A market economy was a network of voluntary cooperation. To be successful, a businessperson needed to provide a good or a service other people were prepared to buy. Businesspeople who prospered would be those who best satisfied the wants of their customers. By each individually pursuing profit, businesspeople as a whole would tend to be led, as if by an 'invisible hand', to undertake those activities that best serve the needs of society.

Over the two centuries following *The Wealth of Nations*, the invisible hand of the market economy - wherever it has been allowed to operate - has exhibited its extraordinary fecundity. The incentives provided by markets, and their capacity to process and coordinate widely dispersed information, have repeatedly proved far superior to any system of central planning. Competition and choice are built into the system, since consumers are free to take their spending power elsewhere. Because businesspeople are competing with one another, a market economy involves material progress almost by definition. To stay successful, there is a constant search on the part of businesses for better ways of doing things - providing new products, cheaper products, or products that in some other way better meet the needs of consumers.

Yet despite its manifold successes, the market economy - and in particular its big business component - has always had its critics. Many of these criticisms have been

on an emotional rather than a logical level. Few have involved much cogent argumentation based on the real world, rather than the insulated world inhabited by many of the critics of business. It has frequently been claimed, for instance, that under a market economy 'the rich get richer and the poor get poorer'. Yet as early as the middle of the nineteenth century, the conditions of life for the working class in England were improving on virtually every objective measure. This posed a problem for Karl Marx, whose thesis was that the proletariat under capitalism would continually be ground down. His 'solution' was to omit from *Das Kapital* the most recent years of available statistics - effectively to falsify his evidence. Similar techniques are still employed today, despite the wealth of evidence that competitive market economies are the most powerful instruments for lifting populations out of grinding poverty.

Of course, not all critics of the market economy are dishonest. But there are many myths about the market that result from sloppy thinking. One of the most frequent mistakes is to confuse the self-interest which drives a market economy with the negative quality of selfishness: markets are said to 'encourage selfishness'. Some people labelled the 1980s in Britain and the United States as 'a decade of greed', seemingly because the Thatcher and Reagan economic reforms allowed many people to use their abilities and energies to make money for themselves. Though such people could generally grow wealthier only by providing services valued by others, and though the general standard of living in both countries rose markedly over that decade, all of this was stigmatised as 'selfish' by a certain class of critic.

New Zealand has certainly not been immune to myths about business. A suspicion of the marketplace, and an assumption that a heavy government presence in the economy is necessary, have been part of our culture for much of our history. Though this attitude is less widespread than prior to our economic reforms, many anti-business attitudes linger on in various guises.

One of these is the attitude so often manifested in New Zealand towards people who have made money. Deng Xiaoping, China's venerable leader, had no difficulty in persuading people in his country that "to get rich is glorious", but that particular socialist credo does not seem to have caught on in New Zealand. Many in the chattering classes are particularly allergic to the idea of high rewards to top people in business. These rewards are often seen as undeserved. Ours is a curiously selective type of censoriousness. It hardly ever applies to All Blacks, models, opera singers, golfers, television personalities and others who earn high incomes - many of whom were born with unusual natural gifts which may in some sense have been undeserved. Yet the school of resentment certainly lets its views be known about remuneration in private business, and about top earners in the public sector.

In all of these cases, of course, the high rewards earned by the most outstanding performers reflect the value of the services they provide. Our top business executives do jobs that are among the most difficult and demanding in the country, and in a highly competitive environment. Their companies undertake huge investments on behalf of savers at home and abroad, and are responsible for the livelihoods of thousands of people. By definition, many of these business executives are among our most able New Zealanders. Yet even a sensible newspaper like *The Dominion* felt compelled recently to splash across the top of its front page the newly-divulged salary of the chief executive of Telecom, as if it could possibly be major 'news' that Roderick

Deane is paid a lot of money. Given his record in both government and the private sector, it would have been news indeed if Dr Deane's salary had *not* been high. One of the reasons we have one of the most efficient telecommunications sectors in the world is that high-quality people with international career options are being paid sufficiently to apply their skills to maintaining that standard of excellence. Yet despite that, an international survey has revealed that the pay differential between chief executives and unskilled workers in New Zealand is one of the lowest in the western world.

Another widespread - and more serious - misconception in New Zealand is that business is often corrupt, that it manipulates politicians and that there is altogether too cosy a relationship between big business and politics. The direct opposite is much closer to being the truth: New Zealand has an enviable record of incorrupt government. There has not been a single serious case of proven corruption by a government minister within the living memory of the great majority of New Zealanders. The incorruptibility and political impartiality of our judiciary is also taken for granted. This cannot be merely a matter of surface appearances: we know from our daily experience that bribes and backhanders are not the way most New Zealanders operate. We simply do not have a culture of corruption in this country. And the relationship between business and politics in today's market economy is far more distant than it was in the days of pervasive government intervention in the business sector.

Our experience is in the sharpest contrast to many other western democracies - to say nothing of third world countries. In Japan, corruption involving high-ranking politicians and business figures was recently exposed. In Italy, some of the most prominent names in politics have been similarly implicated. Spain, France and even Germany have all had major scandals involving government ministers in recent years. The United States has seen Watergate, while Australia is well known as a country where political favours have been freely sought and granted. It is no great surprise that in a survey last year of 44 countries by Transparency International, New Zealand topped the field as the least corrupt country in business and politics. Perhaps significantly, we were followed by Singapore and Hong Kong - both countries that share something of our British heritage and are among the freest of market economies.

Our ranking in the Transparency International survey should be a cause for national pride, yet I would wager that not one New Zealander in a hundred is even aware of it. It has received hardly any publicity here, partly because it contradicts the conspiracy theories held by too many people in the media, in politics and even in academia. These conspiracy theories have not stood serious examination. The 1990 Frontline programme *For the Public Good*, which alleged improper influence by big business over the privatisation programme of the last Labour government, was exposed as a flagrantly irresponsible piece of journalism. It cost Television New Zealand its biggest ever penalty from the Broadcasting Standards Authority, plus a payment of an undisclosed sum of money to a defamed former Labour minister.

It is ironic that the producer of that programme, Murray McLaughlin, who left Television New Zealand in the wake of the fiasco, was the journalist behind the next major 'sensational' documentary alleging conspiracy. Sadder but apparently no wiser, Mr McLaughlin turned up across the Tasman as the producer of the *Four Corners* programme that kicked off the events leading to Winston Peters naming Selwyn Cushing in parliament. His accusation that he was offered money by Mr Cushing on

behalf of the Business Roundtable was found by the judge in the resulting defamation case to have contained "not a word of truth", beyond getting Mr Cushing's name right. Mr Peters "was at best reckless, or even worse, he knew the words he used were false". Whatever the legal merits of Mr Peters' technical defence regarding the use of parliamentary privilege, it is noteworthy that he made no attempt to justify in court his defamatory statements.

Mr Peters has been quick in his career to call others to account for their alleged failings. Yet neither Mr Cushing nor the Business Roundtable (of which Mr Cushing has never been a member) have received any apology from Mr Peters for getting his accusation so completely wrong.

None of this is to deny, of course, that one day - perhaps even tomorrow - a politician or top law enforcement officer may be revealed as corrupt, or improperly influenced by a businessperson. Given human frailty, such an event is not impossible - even in a country like New Zealand. While that would be bad news if it happened, it would need to be kept in perspective. There are crooked and unethical people in all walks of life. It would be as unfair to tarnish all politicians or all businesspeople on the basis of one or two incidents as it would be to regard all lawyers or doctors or shopkeepers as scoundrels on the basis of the activities of a small and highly publicised minority.

Having said that, there was undoubtedly behaviour in the business sector in the 1980s that no one would attempt to defend. There were some so-called entrepreneurs who flourished briefly in the environment of the time. The 1987 sharemarket crash ended the careers of most of them. To that extent they got their just deserts from the market (and sometimes later from Her Majesty's judges). If the crash was a learning experience for some of our more insubstantial businesspeople, it was also a lesson to smaller investors. Some discovered for the first time that what goes up on the stock market can also come down. In an economy which had been so tightly controlled for so long, a certain naivety on the part of many people in dealing with financial markets was perhaps a stage we had to go through. While one feels sorry for small investors who lost money, it will always be a fact that investments promising the highest returns carry a very high degree of risk. Strangely, no one seems to regard these 1980s investors as greedy.

It is in the context of this era that the transactions in the winebox inquiry are best viewed. The question as to whether one or more of the winebox transactions involved fraud, or whether they were all merely tax-minimisation schemes (and therefore legal), is still being explored by the Commission of Inquiry. Since the issues here are highly complex, it is important that we guard against a number of potential misconceptions.

For instance, contrary to the impression given to the public by some of the more excitable members of our media, the inquiry is not a trial of any of the businesspeople involved. It is an inquiry into whether the Commissioner of Inland Revenue and the Head of the Serious Fraud Office acted in a "lawful, proper and competent" manner in dealing with the winebox documents, and whether any changes need to be made to our criminal or tax laws in the light of those transactions. If the Commissioner finds evidence that the law has been broken by any of the parties, those parties would still be assumed innocent until proven guilty in a court of law: that is how our legal system works. If they *are* convicted in a court of law, they should naturally face the appropriate penalties.

Tax minimisation on a lawful basis is itself an entirely proper practice. Large numbers of individuals and virtually all businesses do what they can to lower their tax bill. Indeed in the case of companies, the interests of their shareholders demand that they minimise all costs, including tax costs. Directors have a duty to act in the best interests of the company, which includes not paying more tax than is necessary. This has long been understood by the courts. Crossing the line into tax evasion is quite different: it is a criminal offence, punishable with criminal penalties and subject to a criminal standard of proof. While the distinction between tax minimisation and tax evasion is fundamental, it has been blurred in much reporting of the winebox inquiry.

As in other areas of the law, there can be grey areas between the 'legal' and the 'illegal', in which there can be genuine doubt as to how a transaction will be viewed by the courts. This will be especially so if there is no clear case law in a given area. Moreover, courts are not always consistent in their judgments on commercial and tax law. Knowingly breaking an unambiguous law is quite different from undertaking a 'grey area' transaction where you believe you are within the law but you are aware there is a chance a court could find you to be outside it. Obviously the clearer the law, and the more consistently it is applied, the easier it will be for taxpayers to know where they stand.

Since businesses will respond to the incentives built into any tax system, its design is naturally of major importance. Where there are substantial tax loopholes offering opportunity for tax minimisation activities, these loopholes will inevitably be exploited. This is bad for the economy: resources will go into tax minimisation activities, not because these activities are valuable to society as a whole, but because they offer tax advantages. Businesses will be particularly encouraged to invest in exploiting tax loopholes if they face high tax rates. A bad tax system is thus one with high tax rates and many loopholes - the very system we had in New Zealand prior to our economic reforms. A good tax system combines low rates with a tax base broad enough to eliminate major loopholes. That is the system which, by and large, we now have in New Zealand, after a decade of high quality tax reform. Indeed the OECD has termed our tax system probably the least distorting among its member countries.

The winebox transactions date from the period of transition. In the mid-1980s our financial markets were liberalised, but the development of our tax law - which was proceeding on many other fronts - had not caught up with the newly created potential to exploit offshore tax havens. This provided the opportunity for the winebox transactions. Very soon - and earlier than many other countries, including Australia - the government moved to close off these loopholes by introducing a new international tax regime. The new regime was put in place despite considerable opposition from some large New Zealand companies - another of those inconvenient facts running directly counter to conspiracy theories linking government and big business.

Thus the winebox transactions date from a period of time which is now well in the past. There are fewer loopholes in the New Zealand tax system today than in almost any other country, while the law stands ready to punish those found guilty of tax evasion. There is still no reason for complacency. We should always be examining our laws and institutions to see whether there are things we can do better, and business should be part of that continual self-examination. We do not want to see

corruption entering our national life, or some of the wilder business practices of the 1980s becoming more prevalent again.

We should continue as a country to debate policy issues in as open a manner as possible, so that public policy remains a contest of ideas. The Business Roundtable has always operated on this basis. We have no secret agenda; our views are freely available and all are in the public arena. No other business organisation, union, professional association or lobby group in New Zealand has commissioned so much independent research or published so much material. That is how the public policy debate should be conducted in an open society, and we are committed to keeping it that way.

In this context, it is also important to appreciate that freely operating markets, and a limited government role, are among the best weapons against corruption. Where the government has a pervasive role in regulating economic activity, and where it has a large degree of discretion in *how* it regulates activity, the incentives for corruption are greatly increased. That is surely the lesson from corruption-riddled countries. It is also evident from a country like Italy where many laws are regularly broken - including by its politicians. The Soviet Union was perhaps the classic example of a centrally planned economy where hardly anything seemed to get done without a bribe. By contrast, in countries where there are fewer favours to ask of government, and where business is largely left to pursue profits through satisfying customers, the incentives for corruption can only be reduced.

Thus the changes to our economy since 1984 have been a powerful force for more ethical conduct in both business and government. The voluntary cooperation inherent in a market economy also encourages, and is dependent on, many of the other social virtues important to a healthy society. Since good reputation and successful long-term relationships are crucial for most businesses, a market economy requires the cultivation of those personal qualities that assist in maintaining relationships - honesty, courtesy, good faith, and the treatment of people on their merits rather than on the basis of extraneous characteristics. Markets discourage racial or sexual discrimination based on prejudice, since indulging such prejudices represents irrational business behaviour which can only hurt a company's bottom line.

But while an economy based on voluntary cooperation will encourage the civic virtues, it cannot operate in a vacuum. A market economy doesn't generate the values it requires for its successful operation; it must be underpinned by a shared moral culture. Families, schools, churches, community organisations, and all of us as individuals must play a part in upholding the values that are so important to all aspects of a healthy society. There are signs that some of these values are under strain. The trends over the past generation in respect of crime, drugs, illegitimacy, family breakdown and a wide range of other social indicators must be a cause of real concern. So too is the moral relativism that pervades the pronouncements of many commentators on social and economic issues.

There are no easy answers to these problems, but they affect us all. The Business Roundtable is increasingly concerned to play a role in the debate over how we can best strengthen the values that underpin civil society. The book on the New Zealand welfare state by David Green which we published earlier this year was one contribution to that debate. It received an encouragingly positive response. We are

planning a study of issues concerning the family, which is easily the most important institution for passing on values from generation to generation. We make no apology for getting into these areas. Business is only part of a wider civil society, and flourishes only to the extent that civil society is strong.