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**FROM MEDIOCRITY TO EXCELLENCE  
- AND BACK AGAIN?**

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## **FROM MEDIOCRITY TO EXCELLENCE - AND BACK AGAIN?**

Once upon a time there was a small country where business competed with the outside world and did rather well with a range of products it was good at producing. The standard of living was relatively high, and almost everyone who wanted a job could get one.

From its beginnings it was more susceptible than many other countries to pressures for government busy-bodying. But for many years it kept them more or less at bay. Until the first World War, government spending was only about 10 percent of national income.

In other words, the citizens rendered unto Caesar a tithe. You would think that the churches would have some sympathy for such a tax policy. And in those days they did.

Then along came the Great Depression. This was largely a story of government folly, but around the world it was regarded as a failure of free enterprise.

Out of this traumatic experience the country got a new style of government with much more expansive ideas. These included the belief that its industries could make just about anything. The cost really didn't matter. Nor did it matter that activities such as running the wharves were effectively taken over by the trade unions. After all, was not this a very democratic form of worker control - well ahead of its time? The fact that quite a few goods went missing from ports and railyards didn't matter all that much either, because this spread wealth around.

To make sure businesses did the right thing, the government regulated the number of meat processing plants, cinemas, restaurants, liquor outlets, banks, egg producers and much more. Producer boards were set up to ensure exporting was carried out in the right way. The state owned many commercial enterprises, many of which consistently lost money.

The only problem with all this was that over time the economy worked less and less well. It didn't produce enough overseas funds to pay for the imports the citizens wanted. So the government had to ration out travel allowances for those who wanted a little warmth in the winter. People who wanted a new car had to wait for several years unless they had a rich relative overseas who could help out. Many goods that could be bought overseas were simply not available.

Of course, protection all round had the irritating side effect of pushing up costs and prices. Pesky workers then wanted wage increases to compensate. To help keep them under control the government gave the head of the trade union movement an office in the Treasury.

Workers were also looked after by a bunch of big-hearted judges to whom they could appeal if they felt like a wage increase. This saved everybody the trouble of earning a rise the hard way, through productivity improvements.

Initially business people had difficulty with the idea of bureaucrats telling them what machinery they could use in their factories, and whether a truck could carry their goods more than 40 miles.

However, most soon adapted and came up with creative ways of doing much better than if they had had to put up with competitors. Importers discovered

that import licences were a licence to print money. Manufacturers learned that when consumers had Hobson's choice they could make shoddy goods and profits were still almost guaranteed. Meat companies could block competition by persuading the licensing authority there was no need for new plants. Brewers worked out if you bought licensed outlets you had a guaranteed share of the market.

Life for many people in business was good. They could get to the golf course most Wednesdays. They created business organisations to help keep the privileges and subsidies coming. It was a relief to have the government making so many of the difficult decisions for them. The government-owned international airline had so much respect for the wisdom of politicians that it allowed the prime minister to choose the type of engine to be attached to its planes.

Even bureaucrats were spared this kind of trauma. The cabinet decided whether senior public servants could travel to Australia. The Treasury Instructions laid down how to park a car on a hill and when a silver tea service could be bought. I know, because I had to help write them.

By the 1970s, however, it was felt that perhaps the aging infant industries should get around to trying their hand at exporting. Of course this required taxpayers' assistance - heaps of it. The country's thrusting export marketers reluctantly took their first tentative trips to Australia and Los Angeles at the expense of taxpayers - which was much better than having to pay the travel costs themselves. A research survey found that most believed the government should find export markets for them.

It had also become apparent that the big engines of the economy - the meat, wool and dairy industries - were struggling to export profitably. So the official Santa Claus started handing out goodies to them too. They came in the form of things called 'free' credit at the Reserve Bank, SMPs and livestock incentive schemes. Few seemed to notice that all these goodies had been purchased with a lot of borrowed money, and that Santa was getting heavily into debt.

As things got more desperate, people looked to an economic wizard to stimulate and fine tune the economy - a bit of monetary easing here, a bit more government spending there. The problem was that the wizard couldn't even find the right channel. Never one to think small, however, he took to thinking bigger and bigger. Meanwhile more of the population was becoming unemployed, inflation was going through the roof, and the economy was grinding to a halt.

This was New Zealand - as you may possibly have guessed - as at 1984, a watershed year for the country. Not all was bad about the old New Zealand, but years of state paternalism had turned it into an economic and social wreck.

1984 was the year the business community started to grow up. Business leaders like Sir Ronald Trotter had decided the government had to stop taxing ordinary wage and salary earners into the ground to subsidise hopelessly inefficient businesses, and to stop making consumers pay through the nose for poor quality goods and services. Incredible as this may seem to today's chattering classes, who still think business only pursues its narrow self-interest, some business people decided to support policies they knew were good for the country yet often bad for their businesses, at least in the short run.

Fifteen years ago the typical manufacturer believed that the elimination of import licensing, tariffs and export subsidies would result in the total destruction of local manufacturing. One renegade who stood up at a Manufacturers Federation meeting and suggested New Zealand should push for free trade with Australia was roundly attacked and told never to repeat such heresy again.

Today the New Zealand business community has a good understanding of those policies that make for a successful economy and those that don't. Most business people know high government spending and taxing, over-regulation, and state ownership of businesses damage the private sector and keep people out of work. They have also learned that the hypocrisy of the past is unacceptable today. They practice what they preach. They don't tell governments to cut public expenditure in general but increase it on things that benefit them. They know such narrowly self-serving behaviour will be treated with justifiable contempt.

It was to be expected that the first MMP parliament might see some reversion to past patterns of behaviour. The coalition partners came up with the idea of \$100 million worth of hand-outs to business. The Great Interventionist, now in the sky, must have chuckled at this attempt to breathe life into his legacy. But most business people have figured out that one way or another business usually ends up paying for government grants. There's not a great kick in getting presents from Santa Claus that you've paid for yourself. The main business organisations had no qualms about telling the government they weren't interested in the idea - they wanted tighter government spending control and lower taxes instead.

One Auckland manufacturer, Gilbert Ullrich, has criticised business organisations for "looking a government gift horse in the mouth". While claiming that, of course, he doesn't want a return to the past, he has argued for things like tax breaks for businesses and more money for Tradenz, and has set up a group to lobby for government help, "albeit on a ... modest scale". He is scathing about the "economic purists of the Business Roundtable" who apparently don't understand that other countries protect and subsidise their industries. He doesn't want us to reduce tariffs unless other countries do likewise. All this is pure Muldoonism: opening up the economy, Sir Robert used to tell us, meant letting efficient New Zealand industries go to the wall for the sake of a theory. True, the rest of the world is not a level playing field, but you only compound the problems your own industries have competing in it by saddling them with the costs of domestic protection and subsidies as well.

The idea that increasing the funding of Tradenz could materially improve the competitiveness of the export sector is fantasyland stuff. It is doubtful whether there is any role for Tradenz at all beyond perhaps helping small new exporters in particularly difficult and unfamiliar markets - if the government really has any expertise to offer them. Certainly whether Tradenz exists or not is virtually irrelevant to the export competitiveness of industry compared with the efficiency of the internal economy, the flexibility of the labour market, the performance of the education system, the level of taxation and the quality of the regulatory environment.

At least Mr Ullrich is lobbying for handouts with his own money. What is worse is Tradenz financing groups like the Software Association and the Organic Products Export Group which lobby for more state funding - including a bigger budget for Tradenz!

Proposals for business assistance, tax breaks and free trade zones have recently been bandied around by some business interests in Australia. The Australian Treasurer, Peter Costello, has rightly given them short shrift: "I see merit frankly in making as much of Australia as possible subject to free trade and low taxation". Similarly, the Chamber of Commerce and Industry of Western Australia pointed out that the government:

... can adopt an integrated industry policy encompassing tax reform, microeconomic reform, competition policy and other things that really matter in shaping economic performance. Or it can adopt cosmetic gimmicks, with free trade zones, investment ambassadors and the like. ... If we do end up with a bread and circuses policy, the business community will have itself to blame.

The chairman of the Industry Commission in Australia, Bill Scales, recently wrote:

As I travel around the policy forums of this country I am struck by the degree of backwardness in many of the arguments that I hear. Arguments that were fought and lost in the 1970s are appearing again. And the level of understanding that characterised earlier debate seems to have fallen away.

New Zealand is not immune from the same virus. Mr Ullrich has also criticised the Reserve Bank, but he admits that he doesn't know the answer to the problems he perceives it to be creating. It is usually best to do your homework and consider alternatives before speaking out. Others have promoted the bizarre line that the Reserve Bank is somehow an intervention in what is otherwise a free-market economy. What alternative do they suggest? A gold standard? A currency board? There aren't many others.

Not only business people fail to do their homework. Reviewing Brian Easton's recent book, Tim Hazeldine of Auckland University, a perennial critic of New Zealand's reforms, laments that Easton has failed to come up with an alternative, but he is sure there is one. I am reminded of Ronald Reagan's

charming story of the little boy with his head buried in a pile of straw and manure saying, "I know there's a pony in there somewhere."

The reality is that the recipe for running a successful modern economy is well known. New Zealand drew on all the right lessons with the reforms of 1984-93. They ushered in a period of strong and stable growth and sharply falling unemployment.

Since then we have lost the plot again. The private sector has been reeling under the impact of a \$2 billion increase in government spending over the last couple of years. It is about to be hit by a further massive \$5 billion this parliamentary term. The ratio of government spending to GDP has stopped falling. Tax reductions have been deferred. Privatisation has ground to a virtual standstill. The proposed compulsory savings scheme would lead to a massive re-regulation of savings and savings markets. The courts have been allowed to re-regulate the labour market; their efforts, together with the increase in minimum wages, are keeping more people out of work.

The upshot has been a prolonged slowdown in economic growth, even though our economic fundamentals overall remain in much better shape. Some analysts are now saying recovery may be 12 months away. Unemployment is rising, which is a disgrace at a time when the world economy is booming, and fiscal surpluses are declining. As financial market commentators might put it, New Zealand's reputation is now trading in a wider range. We urgently need action to put in place an economic growth package to boost confidence, investment and productivity.

The government rightly points out that it has kept in place the important pillars of the economic framework - the Reserve Bank Act, the Fiscal Responsibility

Act and the Employment Contracts Act - and that it is accelerating moves towards full free trade and implementing other microeconomic reforms. But the problem is the inadequate pace and scale of such reforms, as well as the inconsistencies in macroeconomic policy that have re-emerged with the massive increase in government spending. The combination of these factors has put our internationally competing industries under great stress.

At the same time, other countries have been implementing New Zealand-style reforms and are overtaking us. In just a few short weeks, Tony Blair's government has given the central bank independence, approved the first recent major tollway in Britain, announced plans for tertiary fees, proposed a work-for-welfare scheme, and is contemplating privatising the London Underground - a goal the previous Conservative government backed away from. Even Australia, a laggard in economic reform, is likely to be the world's largest privatiser this year.

If you think that all the relics of old New Zealand have long since disappeared, think again. The subject of Roger Hall's play about bureaucracy, 'Gliding On', was the Government Stores Board. Its successor organisation - GSB Supplycorp - is alive and well and living in the Ministry of Commerce. I would be amazed if the ministry hasn't urged the government many times to abolish it, but so far it has been too timid to do so. There's an enormous amount of lead in our saddle bags that we should be getting rid of. Sooner or later the government will have to get serious about government spending again, including cutting out the low quality spending in its \$5 billion package.

Some government ministers accuse the Business Roundtable of being negative in making such criticisms and of talking the economy down. But it is naive to think that economies can be talked down or up, as Muldoon's failed efforts at

jawboning showed. And the chorus from business organisations is overwhelmingly consistent. As a recent New Zealand Institute of Management circular put it:

A sense of angst seems to be surrounding New Zealand as we struggle with questions of economic performance. ... Business lacks confidence. The country seems directionless and inward looking.

Direction must start at the top, and with the senior ministers responsible for the economy. There is not a lot of point in politicians like John Luxton arguing for the deregulation of producer boards, Simon Upton saying that health care should be mainly a private responsibility, and Warren Kyd advocating privatisation of ACC if they get no backing from the government hierarchy. And it is now clear that after the diversion of the superannuation referendum is over, the government will have missed the opportunity of almost a full year in office to get on with the job.

A Bob Dylan song should be compulsory listening for modern politicians:

You better start swimming or you'll sink like a stone  
Because the times they are a-changing.

Bill Scales put it somewhat less poetically when he wrote:

Any tendency towards reform fatigue must be resisted. Australia cannot take a break when reforms in the rest of the world continue to gather pace. ... We cannot avoid change. We can embrace it and manage it, or wait for it to be forced upon us.

Right now, New Zealand appears to have decided to wait for change to be forced upon us. Politically we have opted for mediocrity again. Contrary to its British counterpart, the Labour Party's policies are even less business-friendly than the government's, and the relations of most of its members with the business community are almost non-existent. New Zealand is unlikely to go

backwards, but other countries will start overtaking us again. Only the electorate at large seems likely to be able to break the impasse.

There are some grounds for hope in community attitudes. Polls show the electorate is unhappy with the present drift. With a few exceptions, the business community has remained more economically literate than most of its overseas counterparts. It has kicked the subsidy habit; like Nancy Reagan on the subject of drugs, it has learned to 'Just say no'. There is not the slightest chance of ideas like those of Mr Ullrich getting traction. Business is continuing to strive to become world class, and it will keep demanding excellence rather than mediocrity in government policies. Young people I speak to are much less attached to the state paternalism of old New Zealand. And the pressures of international competition and the lessons of international experience will keep bearing down upon us.

For those reasons I remain optimistic about the long-term future of the country. The thing I am less sure about is whether we will have to endure several more years of drift and lost opportunities before we get on the move again.