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WHAT BUSINESS IS REALLY SAYING

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This year there has been a strangely disconnected dialogue between the coalition government and the business community on the health and direction of the economy.

On the one hand business groups have been saying that the coalition agreement is bad for the economy, that the government lacks a sense of policy direction and momentum, that New Zealand is falling behind relative to other countries that are pressing on with economic reforms, and that policy makers have not been listening to these arguments.

On the other hand, the government has been telling the business community that New Zealand's widely admired economic framework is intact, that "there will be no pause in the reform process", and that it should "wait for the budget" for major initiatives to be revealed. Recently it has been maintaining that business is asking for more intervention to "kick start" the economy whereas the government wants to get out of business, and that business people should "snap out of it" and be more confident.

The same wide gap in perspectives has been apparent in media commentary.

Last month Colin James argued in an article that "Bolger's handling of [the] coalition blinds business to its success". John Roughan in the *Herald* recently maintained that the overarching framework for growth "remains exactly as it has been for the previous dozen years". He criticised the Business Roundtable and Roderick Deane, accusing them of looking for government direction, and a *Herald* editorial reiterated the view that business should be "beyond dependency".

In stark contrast, just a fortnight ago the *National Business Review* editorialised that:

> Our economy, which should be among the strongest in the world, is drifting into recession under the weight of unjustified public spending and poor government direction. ... [With minor exceptions] the coalition has all but given up making the economy more efficient. Certain ministers talk about reform but nothing is happening.

The business community at large and the public seem to be on the side of the *National Business Review*. A recent *Business Herald*-University of Auckland survey of business executives found that 70 percent rated the coalition's economic management to be worse than that of the previous government, and well over 80 percent wanted more structural reform and privatisation. And a *National Business Review*-Consultus poll of 5 September found that the number of people who think the country is on the right track has fallen to 38 percent while those who think it's on the wrong track have jumped to 51 percent – the highest-ever level since the poll was launched in 1991.

What is going on here? Which perspectives are right? My aim today is to examine the various claims and to clarify what business organisations like the Business Roundtable are really saying.

I want to preface my remarks by making two points.

First, the government deserves credit for maintaining stability in the transition to MMP. The electorate clearly voted for a continuation of the country's economic directions and there have been no major U-turns in policy.

Second, at least as far as the government is concerned, there are signs that it may at last be heeding the business community's concerns. The recent joint statement by the treasurer and the New Zealand Manufacturers Federation on an export growth strategy was especially encouraging in this regard. So it is possible that we can look forward to a more closely shared assessment of New Zealand's current position and what needs to be done to improve it.

Some background is necessary to set the scene for reviewing the present state of the economy.

Few people now need persuading that New Zealand's reform programme vastly improved the country's economic performance and outlook. The Roger Douglas-Ruth Richardson reforms produced a strong and balanced economic recovery beginning in 1992, with economic growth rates of nearly 7 and 6 percent respectively in 1993 and 1994.

Over the last six years around a quarter of a million new jobs have been created, average annual inflation has been 1.9 percent, and the current account deficit has averaged 2.7 percent of gross domestic product (GDP).

Over the last three years average hourly wages have grown by 3.1 percent, after-tax incomes for low and middle income earners have been boosted by one round of tax cuts, and they should have been boosted further in a second round this year.

There is no doubt that over the first half of the 1990s New Zealand enjoyed a greatly improved economic performance, due to greatly improved economic policies.

Equally, however, there can be no doubt that since the Douglas-Richardson period, New Zealand has drifted. Economic growth has slowed to a crawl – in fact it turned negative in the first quarter of this year – and imbalances are showing up in the form of large current account deficits and falling budget surpluses. The two cardinal mistakes that explain these developments are the surge in government spending and the virtual standstill on structural reform.

The warning signs were apparent by early 1995. In its submission in March 1995 on the government's Budget Policy Statement (BPS) – the first under the Fiscal Responsibility Act 1994 – the Business Roundtable argued that the planned increases in government spending were not prudent:

> The substantial savings in debt servicing that are projected are being offset by very significant increases in other spending. This is a risky strategy. It is very dependent on economic growth continuing at high rates. ... A cautious approach and tight expenditure control is therefore warranted. Fiscal discipline has made a large contribution to the improved state of the economy since 1991.

In our 1996 BPS submission we again warned that the government was killing the goose that was laying the golden eggs:

> The recent strong growth in government expenditure suggests there is a risk that New Zealand could lapse back into its old ways, particularly in an election year and if other political parties make irresponsible spending commitments.

We also argued for further structural reforms, asset sales and reduced regulation of economic activity.

These submissions were not heeded. In the two years prior to the election, government spending rose by about $2 billion dollars and is set to rise by a massive $5 billion in this parliamentary term. Since 1995 the only structural reforms that can be regarded as significant are the privatisation of the Forestry Corporation and the 1996 tax cuts. The coalition agreement precluded rather than foreshadowed major new initiatives.

Since the election, ministers and some media commentators have been maintaining that New Zealand's economic framework and directions have been preserved. To assess this claim, we can look at what the government has often described as the key pillars of its economic framework, namely:

- price stability
- fiscal discipline
- a low-rate, broad-based tax system
- an open economy

  and
- a flexible labour market.

With respect to the first pillar of the framework, the coalition agreement extended the Reserve Bank's target range to 0–3 percent. No justification was given for this change, and I have not heard ministers claiming benefits from it. As far as I can see, all it has done is increase the risk premium in New Zealand's interest rates.

The second pillar, fiscal discipline, has clearly collapsed. As Don Turkington, a respected financial analyst, put it earlier this month:

> The government has all but lost fiscal discipline and hard-won surpluses could be in danger.

The blow-out in spending since 1995 has put great pressure on monetary policy and squeezed the export sector. The 1991 lesson of the benefits of balanced fiscal and monetary policies has been forgotten. Clearly, the government's recently announced aim of finding $400 million dollars in savings will hardly make a dent in its $5 billion splurge.

As regards the third pillar, the 1996 tax cuts widened rather than flattened the income tax scale, and the 1997 tax cuts were deferred.

In respect of the fourth pillar, the open economy, the government is to be commended for proceeding with a programme to eliminate all tariffs – this was the only significant initiative to materialise in the budget. On the other hand it has done nothing to remove producer board controls on agricultural exports, the coalition agreement proposes new controls on foreign investment, and immigration has been allowed to slow to a trickle.

On the fifth pillar of the framework, labour market flexibility, the coalition agreement substantially increased the minimum wage and envisages a further increase next year, and the government's work on undoing the Employment Court's record of re-regulating the labour market seems to be taking an eternity. It is little wonder that unemployment is climbing in New Zealand at a time when it is falling in many other countries.

By any measure, this scorecard tells a story not of outright U-turns but of major slippage, particularly on fiscal policy. How commentators can say the framework "remains exactly as it has been" is beyond comprehension. Moreover, the coalition agreement rules out major privatisations and offers no credible solutions to the glaring problems in health, education and welfare.

The consistent pattern in all these changes – higher government spending, the deferral of tax cuts, new controls on foreign investment, re-regulation of the labour market, continuing public ownership of businesses – is more government intervention, not less. It has been extended with proposals for compulsory savings, talk of new interventions in electricity industry, threats to re-regulate telecommunications, proposed energy efficiency regulations, new investment product disclosure regulations, and proposals for whistleblower legislation, controls on CO_2 emissions and the introduction of environmental reporting into the Companies Act. Add in the economic and compliance costs of the Resource Management Act and legislation on human rights, privacy and occupational health and safety and it is hardly surprising that business is struggling to gain momentum and create jobs. We are seeing the most interventionist turn of economic policy for many years.

Business is calling for this pattern of interventions to be reversed, not for new interventions to "kick start" the economy. It is extraordinary that a major paper like the *Herald* could be so out of touch with business thinking. The rejection of $100 million of so-called business assistance ought to have been enough by itself to make that clear. Businesses are perfectly happy to accept the

responsibility of competing, innovating and becoming more productive provided they have a good business environment, free from unwarranted government intrusions and pressures.

Commentators like the *Herald* who think business should just "snap out of it" have not given us a credible explanation of why the economy has been in a trough for two years and why there are still no clear signs that it is pulling out of it. Animal spirits can't be conjured out of thin air. Policy settings have a major impact on any economy's performance. Good policy settings had a hugely beneficial impact in the first half of the 1990s. Inadequate policy settings and a general lack of direction meant businesses lacked confidence to invest and create jobs from 1988 to 1990, and they are having a similar effect now.

I suspect most of us in business today would agree that New Zealand could be doing far better. The International Monetary Fund is projecting annual growth for the world economy of over 4 percent for the next few years, and growth in Asia is projected at 7–8 percent. Growth in New Zealand for the three years 1995 to 1997 is likely to average only 2–2.5 percent, and the Treasury is assuming no more than an average 3 percent growth rate in the period ahead. These rates are well below National's target of 3.5–5 percent growth to 2010 and New Zealand First's target of 6 percent growth by 1999. The business sector and the community are entitled to regard these goals as credible commitments for which governments should be accountable, not political flummery. Clearly a new growth strategy is required to achieve them.

What form might such a strategy take? The Business Roundtable gave its answer to that question 18 months ago in a report entitled *Moving into the Fast Lane*. Let me refer instead, however, to the 1996 OECD report on New Zealand, which provided a broadly similar assessment. No source is more economically mainstream than the OECD, and its report makes salutary reading today. Among its conclusions were the following points:

- "continued robust growth will be required to reverse past declines in living standards relative to other OECD countries";

- "the period of slower growth could be more protracted than assumed, as high real interest rates may hold back domestic demand and exporters may find it difficult to cope with the high exchange rate";

- "the emerging pressure for increased expenditure" should be resisted;

- there would be economic gains from "ongoing reforms of the tax base and reductions in the top personal tax rate";

- "many businesses still owned by the central and local governments should be privatised";

- "the mandated powers of producer boards remain an anomaly, being a barrier to innovation and entrepreneurial activity in the agricultural sector";

- "the monopoly accident compensation scheme looks likely to impose escalating costs on employment in the absence of substantial changes" and "[a]t the very least there is no reason why extensive private delivery could not be introduced"; and

- "in the education sector, much remains to be done to generalise direct resourcing of schools" and discontinue "centralised practices in the contracting of teachers and in the negotiation of their wage rates".

To date there has been minimal progress on this agenda, which is by no means exhaustive. And if the government thinks the OECD's approach is mistaken and has an alternative growth strategy, we haven't heard about it.

Yet policies of fiscal restraint, lower taxes, privatisation and deregulation continue to be advanced or advocated in practically every corner of the world. China, still notionally a communist country, has just decided to embark on wholesale privatisation of its state enterprises. Deng Xiaoping used to say that it doesn't matter whether the cat is black or white as long as it catches the mice. Now, as one journalist observed, it doesn't seem to matter in China who owns the cat. In New Zealand, by contrast, ideologues in the Alliance, local government and the media defend socialist notions of public ownership and the government seems strangely reticent about treating them with the ridicule they deserve. And those in the National Party who say they would like to see privatisation of, for example, the electricity industry are apt to forget that the party went into the last election opposed to such a policy.

I suggested earlier that the government may be starting to accept what business has been saying about a lack of economic leadership and direction, and may be turning its mind to a strategy for economic growth. The treasurer's recent indication of a desire to reduce the top tax rates was a positive signal. The prior requirement, however, is to regain fiscal discipline. Much of the $5 billion package, which is generally of low quality, should be revisited. To permit ongoing tax reductions, the government should commit itself to reducing the ratio of government spending to GDP to 25 percent over five years as proposed by the Manufacturers Federation. Substantially reducing this ratio is the single most important step the government could take to resuscitate growth.

Beyond this, the government has ample opportunities in front of it over the next few months to take decisive action. Legislation before parliament could be amended to wind up the meat and wool boards, and next month's kiwifruit industry summit provides a platform for a start to deregulation of the single seller boards. Instead of its present interventionist strategy towards the electricity industry, the government should be giving priority to a strategy for withdrawing from ownership at both the central and local government level. Decisions to corporatise roading and to transfer infrastructure assets such as those of the Auckland Regional Services Trust to the private sector would help remove bottlenecks to growth. Deregulation of ACC, welfare reform, the development of an approach to superannuation based on the Todd Task Force's next report and changes to resourcing and employment arrangements in education could all be tackled in the near future given the background work that has been done.

In view of the widespread public belief that the government is on the wrong track, it should not be difficult for it to gain support for new directions with strong leadership and communication.

The current superannuation referendum seems likely to confirm that the public can reach sound conclusions given proper information and debate. A compulsory savings scheme is a thoroughly bad idea, but initial polling suggested majority support for it. As its drawbacks were exposed, opinion shifted significantly. The lesson I draw is that New Zealanders are quite capable of coming to sound conclusions on complex topics if governments take the public with them.

I have little doubt that a government-led communication effort to make the case for ongoing reforms to improve New Zealand's economic performance would attract public support, just as most of the earlier economic reforms are now uncontroversial. If it didn't, the electorate would only have itself to blame when unemployment rose, welfare dependency increased, social services deteriorated and New Zealand fell further behind leading first world countries once again.